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The Supreme Court of the United States

OCTOBER TERM, 1933.

No. 114.

THE STATE CORPORATION COMMISSION FOR THE STATE OF KANSAS, HOMER HOCH, JESSE W. GREENLEAF, ET AL.,
APPELLANTS,

vs.

THE WICHITA GAS COMPANY, HUTCHINSON GAS COMPANY, NEWTON GAS COMPANY, ET AL.,
APPELLEES.

BRIEF ON BEHALF OF APPELLANTS.

OPINIONS OF THE COURT BELOW.

The majority findings and opinion of the Court below and the findings and dissenting opinion of Judge Hopkins, are reported in 2 Fed. Supp. at page 792. They appear in the record of this proceedings at pages 277-361.

RULE 12.

Rule 12, paragraphs one and two, has been complied with and this court has held it has jurisdiction to entertain the appeal.

STATEMENT OF THE CASE.

This is an appeal from the findings and decree of a statutory three judge court convened in the United States District Court for the District of Kansas, First Division, consisting of Orie L. Phillips, C. J., George T. McDermott, C. J., and Richard J. Hopkins, D. J.

The decree granted a permanent injunction against the Public Service Commission. The matter had been submitted upon the issues joined by the bills of complaint, (R. 1-247), and the answers thereto. (R. 251-266) The bills of complaint all attack the same order of the Commission and were similar in all particulars. Therefore, only the bill of complaint of the Wichita Gas Company and the Cities Service Gas Company and the answers thereto were set out in the record, as the cases were consolidated for trial and treated both in the court below and on appeal as a single case covering a single issue. (R. 249-251)

The Cities Service Gas Company, a Delaware corporation, is engaged in the business of producing and transporting gas from Texas, Oklahoma and Kansas and delivering it to distributing companies along its line, among which are the following in the State of Kansas: The Wichita Gas Company, The Hutchinson Gas Company, The Pittsburg Gas Company, The Capital Gas and Electric Company, The Newton Gas Company, The Gerard Gas Company, The Wyandotte Gas Company, The Union Public Service Company, and The Western Distributing Company.

The common stock of each of such distributing companies, excepting the qualifying directors shares, is owned by The Gas Service Company. The stock of the Gas Service Company, excepting the qualifying directors shares, is owned by The Cities Service Company, a Delaware corporation. The stock of the Cities Service Gas Company, excepting the qualifying directors shares, is owned by The Empire Gas and Fuel Company. The stock of The Empire Gas and Fuel Company, excepting the qualifying directors shares, is owned by the Cities Service Company. (R. 538)

The Western Distributing Company is a West Virginia corporation and a citizen of that state. The Union Public Service Company is a Delaware corporation and a citizen of that state. The other distributing companies are Kansas corporations. The Cities Service Gas Company furnishes gas to the distributing companies at the city gates under a day to day contract, which is oral, usually at 40¢ per thousand cubic feet. In some instances it is less, making average of 39.5 cents (R. 294). Each of the distributing companies has contracted to pay to Henry L. Doherty & Co., 1 and ¾ per cent of its gross revenue, a per diem charge and expenses for certain specific services, and an engineering fee of 5 per cent of the cost of new construction, in consideration of which Henry L. Doherty & Co. maintains legal, managerial, engineering, accounting and purchasing staffs, whose services are available to the distributing companies. The Commission disallowed the 1 and ¾ per cent item as an unreasonable and unnecessary

expense. This finding was not disturbed by the District Court, has not been appealed from by the companies and therefore is not in controversy on appeal. (R. 300)

Each of the distributing companies has also entered into a contract with the Gas Service Company under which the latter agrees to furnish and the former to pay for certain services similar in nature to those contracted for with Henry L. Doherty & Co. The Commission found that one such contract was reasonable, and having disallowed the one with the Henry L. Doherty & Co., approved the contract with the Gas Service Company. Therefore, this contract is not in controversy on appeal. (R. 77)

On July 2, 1931, the Public Service Commission commenced a proceeding against the corporations hereinbefore named, except the Cities Service Company, and the Cities Service Gas Company. It found that the reasonableness of the contracts hereinbefore referred to, and the charges made for services and commodities furnished thereunder, should be inquired into and a determination made of the amounts which properly should be set up as operating expenses of the distributing companies on account of expenditures made for such commodities and services under such contracts, and entered an order on such findings for a hearing to inquire into the reasonableness of such contracts and charges, and directed that respondents in such proceeding furnish such information concerning such contracts as the Commission might desire, and

"show cause why such holding company contracts or service or commodity charges, should they be found unreasonable, should not be disallowed as operating expense of the distributing companies, and adjustment made in this respect as to charges made to the consumers." (R. 26)

The Public Service Commission assumed jurisdiction to inquire into the reasonableness of the contracts under the authority expressed in the case of Smith v. Illinois Bell Telephone Co., 282 U. S. 133, and Western Distributing Co. v. Public Service Commission of Kansas, 285 U. S. 119.

The hearing was commenced before the Commission on October 16, 1931, and closed February 16, 1932. During this time, the Commission heard testimony for twenty six full days and received 101 exhibits, some of the exhibits containing several thousand pages. There was testimony from 40 witnesses and the evidence, when finally transcribed, consisted of 2,991 pages of testimony.

After the submission of the briefs, the Commission, on July 20, 1932, made findings to the effect that any amounts paid by the distributing companies under their contracts with Henry L. Doherty & Co. because of the 1 and ¾ per cent agreement, were unreasonable and not a proper item of expense, and that any amount paid by the distributing companies to the Cities Service Gas Company for gas in excess of 29.5¢ per thousand cubic feet at the city gates, was unreasonable, and ordered that on and after August 1, 1932, the distributing companies should:

1. Cease setting up on their books as operating expense, the 1 and ¾ per cent payments made to Henry L. Doherty & Co., and any payments made for gas to the Cities Service Company in excess of 29.5¢ per thousand cubic feet,

2. Give no consideration to any such payments in fixing their rates to domestic consumers,

3. Reduce their rates to their consumers proportionately, pending a final determination of their rates; and show cause on September 1, 1932, why such reduction should not be made permanent. (R. 182)

A petition for rehearing was filed by the respondents setting up 51 grounds. A rehearing limited to one of such grounds was granted which pertained to the earnings of the Company for the year ending June 30, 1932. After such rehearing, the Commission increased its finding of a reasonable charge for gas at the city gates from 29.5¢ to 30¢, and with that modification and the necessary changes in dates, on August 31, 1932 re-entered its order of July 20, 1932, in the form of two orders. The material portions of the first of such orders is as follows:

> "That on and after the first day of September, 1932, the distributing companies, respondents above named, shall cease to set up on their books as an expense item any payments made to Henry L. Doherty & Company under the contract above mentioned, because of the one and three-fourths per cent charge, and also any payments made to Cities Service Gas Company for main-line town border gas in excess of 30 cents per M. C. F., and should give no con-

sideration to any such payments in fixing a rate for the domestic consumer.

That on the 17th day of October, 1932, the distributing companies, respondents above named, appear before the Public Service Commission, at 10 o'clock A. M., and show cause to the Commission why the reduction in expenses as above set forth should not be passed on to the consumers with such other reductions as may be found reasonable." (R. 59-62)

The material portion of the second of such orders is as follows:

"It is therefore by the Commission ordered, that effective September 1, 1932, and until a hearing is held and an order issued, that the distributing companies, respondents above named, shall charge rates to the consumers as follows:

All distributing companies paying a gate rate in excess of 30 cents per M. C. F., shall deduct the difference between what the distributing company is now paying at the city gate and 30 cents per M. C. F. and pass on this difference to the consumer." (R. 62-3)

The reasonableness of the contracts was tested before the Commission on the basis of the cost of rendering service, plus a reasonable return upon the present fair value of the property used and useful in rendering the service.

The distributing companies and the Cities Service Gas Company brought separate suits in equity to enjoin the enforcement of the two orders of August 31, 1932. The Public Service Commission of the State of Kansas and Jesse W. Greenleaf, Thurman Hill and C. W. Campbell,

as members of said Commission, and Kendall Hoyt, Attorney General for the State of Kansas, were made parties defendant.

These actions were commenced on September 19, 1932, within the thirty day period required by section 66-118 Revised Statutes of Kansas, 1923.

The several bills alleged diversity of citizenship as to the Cities Service Gas Company, the Western Distributing Company, and the Union Public Service Company, and alleged that the orders are confiscatory of plaintiffs' property, impair the obligations of their contracts, deny to them the equal protection of laws, and unconstitutionally interfere with interstate commerce.

An application was made for a temporary injunction. At the hearing thereon, the Commission confessed that the second order made on August 31, 1932, was in conflict with Section 66-118, Revised Statutes of Kansas, 1923, which prescribes that an order cannot become effective until thirty days after it is entered, and consented that the enforcement of such second order might be permanently enjoined. The temporary injunction was granted against the enforcement of both orders.

The cases were consolidated for trial. (R. 248-250) Upon the trial, the evidence introduced before the Commission was received in evidence, supplemented by an agreed abstract of such evidence, and by stipulations and other evidence. (R. 282)

The case was heard by the statutory three judge court on the 10th day of November, 1932. The case was taken under advisement and on the 5th day of

January, 1933, Judge Phillips handed down an opinion and findings of fact concurred in by Judge McDermott. The opinion and findings of fact increased the value and rate base as found by the Commission from $73,170,010 to $82,080,[illegible]. The opinion and findings decreased the net income available for return on investment as found by the Commission, from $6,703,836 to $6,[illegible]. The majority court found further, that on these calculations, the Company would be making but 7.11 per cent and the reduction of 6½ cents per M. C. F., as ordered by the Commission, would reduce the rate of return to 6.6 per cent, which it found to be confiscatory.

On the 14th day of January, 1933, Judge Hopkins handed down findings of fact and a dissenting opinion holding that the order of the Commission was reasonable and supporting the findings of the Commission with but a few immaterial exceptions as to the valuation and net earnings.

On January 16, 1933, the majority Court handed down a supplemental memorandum consisting of an interpretative resume of its former opinion pertaining to the reasonable rate of return.

On the 28th day of January, 1933, the statutory three judge court entered its decree in part as follows:

> "That the defendants, the Public Service Commission of the State of Kansas, and the members thereof, and Ronald Boynton, Attorney General of the State of Kansas, and each of them, their agents, servants, and employees, and all other persons act-

ing under or through their authority, be and they are here permanently enjoined and restrained in the enforcement and execution of the provisions of two certain orders of said Public Service Commission, dated August 31st, 1932, insofar as the said orders require that the distributing companies, plaintiffs in the above named cases, should cease to set up on their books any payments made to Cities Service Gas Company for main line town border gas in excess of 30 cents per M. C. F., and should give no consideration to any such payments in fixing a rate for the domestic consumer; and, insofar as they and/or either of them require that effective September 1, 1932, and until a hearing is held and an order issued, the said distributing companies should charge rates to the consumers as follows:

All distributing companies paying a gate rate in excess of 30 cents per M. C. F. should deduct the difference between what the distributing companies were then paying at the city gate and 30 cents per M. C. F., and should pass this difference to the consumer." (R. 361)

Said decree did not enjoin the Appellants from enforcing the order as to the payment of the 1 and ¾ per cent to Henry L. Doherty & Company, and this appeal is only from that part of the decree enjoining the enforcement of the orders of the Commission as to the gate rate for gas at 30 cents per M. C. F. The Appellants objected to and took exception to findings Nos. 13, 14, 16, 17, 18, 19, 20, 21, and to the conclusions of law No. 1, and to that part of the decree which enjoined the Public Service Commission of the State of Kansas in reference to its said orders, and exceptions thereto were allowed. (R. 362)

The Appellants presented their application for appeal, their assignments of error, and bond for appeal on the 19th day of April, 1933, and the appeal was allowed on that date. (R. 367) A condensed statement of the evidence essential to a decision of the questions presented on appeal appears at pages 368 to 539, inclusive, of the record, and a statement of the points relied upon by the Appellants, may be found in the record at page 541.

After the entering of said decree the 1933 Legislature of the State of Kansas, abolished the Public Service Commission of Kansas, and recreated the same as the State Corporation Commission of Kansas, and by said act the terms of office of Jesse W. Greenleaf, Thurman Hill and F. E. McMullan, successor to C. W. Campbell, expired and Homer Hoch, Jesse W. Greenleaf and Ernest E. Blincoe succeeded them as members of the State Corporation Commission.

On the 19th day of April, 1933, the said District Court made an order substituting the said The State Corporation Commission and Homer Hoch, Jesse W. Greenleaf and Ernest E. Blincoe as members thereof as defendants in place of the defendants, The Public Service Commission of Kansas and Jesse W. Greenleaf, Thurman Hill and C. W. Campbell. (R. 362)

SPECIFICATIONS OF ASSIGNED ERRORS.

The errors assigned are as follows: (R. 311)

1. The District Court of the United States for the District of Kansas, First Division, erred in permanently enjoining and restraining the enforcement and execution of the provisions of the two certain orders of The Public Service Commission as dated August 31, 1923, insofar as the said orders require that the distributing companies, plaintiffs in the above cause, should cause to set up on their books any payments made to The Cities Service Gas Company for manufactured town border gas in excess of 30 cents per M. c. f., and should give no consideration to any such payments in fixing a rate for the domestic consumer.

2. The Court erred in refusing to dismiss the plaintiff's bills of complaint and in granting the petitioners any relief.

3. The Court erred in their opinion and findings declaring the order of The Commission was, as to any part, unreasonable and would, if not enjoined, confiscate the property of these plaintiffs.

4. The Court erred in not accepting the finding of facts, declarations of law and dissenting opinion of Honorable Richard J. Hopkins, as declaratory of the law and facts controlling in this case.

5. The Court erred in finding:

> "The present values are on the extensive construction of the last few years, less than the prudent investment therein * * * " (Finding 13.)

6. The Court erred in finding the rate base to be $[illegible] (Finding 14.)

7. The Court erred in finding the present value of The Ohio Fuel Gas Company's rights of way to be $1.02 per rod and erroneously increased the valuation in the amount of 22 cents per rod on rights of way, a total increase of $[illegible] (Finding 14; Account 1307, 1327.)

8. The Court erred in adding $24,318 to the cost of gas well construction as found by the Commission. (Finding 14, Account 1312), and thereby erroneously increased the rate base in said amount.

9. The Court erred in adding $387,011 to the value found by the Commission for production field line equipment, (Finding 14, Account 1344), and thereby erroneously increased the rate base in said amount.

10. The Court erred in finding that the Hogshooter compression station was used and useful, and in adding to the value found by the Commission, $2,100 for land at the Hogshooter station, $43,560 for compression station, and in adding the value of the equipment at the Hogshooter station in the amount of $414,927. (Finding 14, Accounts 1325, 1328, 1331.)

11. The Court erred in finding that the value found for Account 1333 by the Commission should be increased from $39,432,331 to $40,232,331, because the amount of rock excavation in the pipe line construction allowed by the Commission was too low. (Finding 14.)

12. The Court erred in finding that going concern value should be placed in the rate base at $5,000,000.

and the value found by the Commission increased $3,[illegible],000 (Finding 14)

13. The Court erred in finding that 1,201,000 acres of gas leases owned by The Cities Service Gas Company were used and useful, and should be included in the rate base including development, proven, probable and prospective acreage, and erred in increasing the acreage allowed as used and useful and in valuing the same at $3,[illegible] (Finding 14)

14. The Court erred in finding that the net income available for return amounted to only $3,[illegible], and in including a portion of the rate expense of the present investigation as a proper item of expense in arriving at the net earnings available for return (Finding 16)

15. The Court erred in allowing $[illegible] as annual replacement requirements on account of rentals on non producing leases (Finding 16)

16. The Court erred in finding that $174,747.74 was necessary as an annual allowance for dry hole expense (Finding 16)

17. The Court erred in its finding and conclusion that The Cities Service Gas Company is earning an annual return of only 7.11 per cent on the present valuation of its property (Finding 17)

18. The Court erred in its finding and conclusion that approximately 8 per cent return upon present valuation is necessary for The Cities Service Gas Company at the present time, and that a return substantially lower than that would be confiscatory; and erred in its find-

ing that if abnormality is considered, the return must be increased and not decreased. (Finding 18.)

19. The Court erred in its finding that under the orders of the Commission, the return upon the property of the Ohio Natural Gas Company dedicated to the public use would be 4.8 per cent, and erred in its finding that such rate under present conditions is confiscatory. (Finding 19.)

20. The Court erred in its finding that if the distributing companies are compelled to pay 40 cents per thousand cubic feet for gas at the city gates and to base their rates to consumers upon the gross fixed as reasonable by the Commission, no one of them will have earnings in excess of operating expenses applicable to depreciation and return. (Finding 20.)

21. The Court erred in its conclusion of law that that portion of the first order of the Commission, made August 31, 1912, providing that the distributing companies should give no consideration to the payments for gas at the city gates in excess of 30 cents per thousand cubic feet in fixing the rate for domestic consumers, should be permanently enjoined. (Conclusion of law, 1.)

22. The Court erred in its conclusion that 40 cents per thousand cubic feet for gas at the city gates is a reasonable charge. (Opinion.)

SUMMARY OF ARGUMENT.

The lower Court concluded as to the jurisdiction of the Commission herein as follows:

> "We are of the opinion that the facts here justify the conclusion that the Cities Service Company, together with the Gas Service Company, the distributing companies, The Empire Gas and Fuel Company, and the Cities Service Company, are engaged in a common enterprise, namely, the transporting and furnishing of gas to local concerns; that the Cities Service Company exercises such complete dominion and control over the Cities Service Gas Company and the distributing companies that under the general rules of agency, the Cities Service Gas Company and the distributing companies are mere agencies or instrumentalities of the Cities Service Company; and that in substance and effect the Cities Service Company is, through such agencies, supplying gas to local consumers on demand and is engaged in a local business. If this be true, the Commission had the power to determine the reasonableness of the charge set up as operating expense for gas at the city gates in fixing the local rate. That could only be done by determining a reasonable return to the Cities Service Gas Company for producing, transporting and delivering such gas at the city gates." (R. 286)

The lower Court concluded that it must determine the value of the property of the Cities Service Gas Company used and useful in the business of producing, transporting and delivering gas, the amount of its earnings and a fair return upon such property.

With both of the above conclusions of the lower Court, appellants agree.

Appellants contend:

1. The majority lower Court erroneously increased the value of the property of the Cities Service Gas Company used and useful in its business of producing, transporting and supplying gas to the distributing companies at the city gates, from $73,170,510 as found by the Commission to $82,380,583.

2. The Court erred in its finding that all of the gas leases held by the Company in the amount of 1,262,361 acres were used and useful, regardless of their developed, proven, probable or prospective character.

(a). Of the above leases there were 998,287 acres which the Company classified as prospective only. They were not even known to be capable of producing gas and a large part of them were far removed from the present system.

(b). Of the 1,262,361 acres there were 123,440 acres, proven but not developed, located in the Hugoton field. The Hugoton field is over 90 miles from any pipe line of the present system. A major addition to the present system is necessary to make this field available.

(c). The Company owned 69,367 acres of other leases 24,547 of which was situated outside the proven sweet gas area, some being in the sour gas area and not suitable for domestic consumption, and the remainder is not developed.

(d). The Commission allowed 71,267 acres as used and useful and the evidence given by the Company's own witnesses showed conclusively that within said 71,267 acres there was sufficient gas to last the Company for

over 22 years, on the basis of its requirements for produced gas in 1930.

(e). We contend that the gas leases which a company should be allowed to place in the rate base as used and useful should under no circumstances exceed an amount sufficient to meet the needs of its patrons for a reasonable time in the future. The actual facts as to the gas consumption of the Company's patrons are in the record. The actual facts pertaining to the available gas were carefully calculated by expert geologists for the Company and substantiated by the expert geologists for the Commission. The Company's officers testified that all the leases were acquired as gas reserves for this pipe line and in their judgment were a necessary acquisition. We submit that the assumption of the Company's officers cannot stand against the facts. The excess leases may be a prudent investment for the Company, but they are not used and useful in serving present patrons.

3. The Commission had an opportunity to observe all of the witnesses, went carefully into all of the evidence as shown by its opinion and findings, and the record before the Court below did not disclose any substantial reason sufficient to overcome the presumption that the findings of the Commission were correct.

4. That the majority lower Court erroneously found:

> "Under the present rates, the Cities Service Gas Company is earning 7.11 per cent a year upon the present value of its properties." (R. 317)

5. The majority lower Court erroneously found, contrary to the evidence, that:

> "A return of approximately 8 per cent upon present values is necessary, under present conditions, to assure confidence in the financial soundness of the Cities Service Gas Company, to maintain its credit, and to enable it to raise money necessary for the discharge of its public duties. Any return substantially lower than that would be confiscatory. (United Railways v. West, 280 U. S. 234, 252.)" (R. 317)

There is no evidence that any further financing is necessary. In fact, the evidence shows that the Company is fully financed.

6. That the majority lower Court erroneously construed the law as stated in the West case, supra, when it applied it to the facts in the case at bar.

7. That the majority lower Court in its Finding No. XVIII found that these times are abnormal and then erroneously found that if abnormality is considered, the return must be increased, not decreased. (R. 318) It therefore appears that the lower Court concluded that the more difficult and depressed the times, the more the utility should earn. Developing this conclusion, it would appear that as the ability of the patron to pay decreases, the rate of return of the utility increases.

8. That the majority lower Court erroneously found the net available annual return from such property to be $5,860,327.

(a). The majority lower Court erroneously deducted from net income $329,917 as annual depletion requirements for rentals on nonproducing leases. We contend

that the allowance is improper due to the fact that the Company is carrying 998,287 acres of prospective leases not even known to be capable of producing gas and many so far from the pipe line that they are not accessible to the system. These leases are not useful at the present time, and as we have said heretofore, are entirely in excess of an amount required to meet the needs of its patrons for a reasonable time in the future.

(b). The lower Court erroneously deducted from net income $174,747 as an annual allowance for dry hole expense. The prospective acreage is not useful. In the proven area all of the evidence shows there is little likelihood of encountering a dry hole and in the proven sweet gas area of the Amarillo field, no dry hole has yet been encountered.

The Company now has ample proven gas reserves sufficient to last it for many years in the future and its period of pioneering is past.

9. That the majority lower Court erroneously concluded that 40 cents per thousand cubic feet for gas at the city gates is a reasonable charge.

10. That the majority lower Court erroneously concluded that to compel the Cities Service Gas Company to furnish gas at 30 cents per thousand cubic feet will result in a confiscation of its property.

11. The majority lower Court erroneously failed to give consideration to the fact that earnings had decreased during the test period due to loss of sales of industrial gas.

The value of the service to the domestic consumer has not increased. Where the rate for domestic consumption is attacked as confiscatory, consideration should be given the fact that the decrease in earnings upon which the claim for confiscation is based grew out of loss in industrial sales. A temporary loss created by one class should not be made a burden upon another.

The rights of a particular class of patrons cannot be ignored. A utility should not be allowed to maintain rates that are unjust to one class of its patrons because there has been a temporary loss of income from another. The constitution does not require that temporary loss in income be remedied by imposing an unreasonable burden upon another class of patrons, with no increase in the value of the service. (Covington & L. Turnpike Road Co. v. Sanford, 164 U. S. 578)

12. That the findings of fact, declarations of law and dissenting opinion of the minority lower Court should be declaratory of the law and facts controlling in this case.

ARGUMENT.

JURISDICTION OF THE COMMISSION.

The Court sustained the Commission's finding as to jurisdiction to investigate into the reasonableness of the 40 cent contract, no exceptions were taken thereto and no appeal was taken therefrom. It is believed, however, that a brief discussion of the theory of jurisdiction will throw some light on the findings of the Commission and the Court below, and be helpful in considering the findings as to value and net available annual return.

The Commission assumed jurisdiction under the authority expressed in the recent case of Western Distributing Co. v. The Public Service Commission of Kansas, 285 U. S. 119. In that case the same question existed as to the right of the Commission to require evidence as to the reasonableness of the 40 cent contract. The same holding companies and the same pipe line companies were involved. The Western Distributing Company one of the appellees herein, was the plaintiff and appellant in that case. In that case, the Court said:

> "The appellant adverts to the fact that in its bill of complaint are included a number of averments not denied by the appellees. In brief these are that the company does not own or produce any natural gas; that the only source of supply for the city of El Dorado is the main of the Cities Service Gas Company; that no supply at a lower price can be obtained from any other source; that the same rate is being charged to other distributing companies

> along the lines of the Cities Service Gas Company, and was being charged by another independent pipe line to another city; that an ineffectual effort had been made to find local gas available to El Dorado; and that appellant had attempted to get a lower rate from Cities Service Gas Company, but could not do so. It is urged that as these averments were uncontradicted they constitute, when taken with the facts previously stated, a prima facie case for the reasonableness of the rate charged. This might well be true were it not for the fact of unity of ownership and control of the pipe line and the distribution system. An averment of negotiation and effort to procure a reduction in the wholesale rate means little in the light of the fact that the negotiators are both acting in the same interest, that of the holding company which controls both. All of these facts so averred in the pleadings would be far more persuasive with respect to the propriety of the rate if the parties were independent of each other and dealing at arm's length.
>
> Where, however, they constitute but a single interest and involve the embarkation of the total capital in what is in effect one enterprise, the elements of double profit and of the reasonableness of inter-company charges must necessarily be the subject of inquiry and scrutiny before the question as to the lawfulness of the retail rate based thereon can be satisfactorily answered." (See also Smith v. Illinois Bell Telephone Co., 282 U. S. 133.)

It is admitted by the Appellants that a State Commission cannot fix the price to be charged for natural gas transported from one state to another, sold and delivered in bulk to an independent distributing company. The Commission was of the opinion, however, that the facts here justified the conclusion that the Cities

Service Company, together with the Gas Service Company, the Empire Gas and Fuel Company, the Cities Service Gas Company and the distributing companies are engaged in a joint enterprise for the transportation and furnishing of gas to local consumers, that the Cities Service Company exercises such complete domination and control over the Cities Service Gas Company and the distributing companies that under the general rule of agency the Cities Service Gas Company and the distributing companies are mere agencies or instrumentalities of the Cities Service Company; and that in such status and effect, the Cities Service Gas Company is, through such agencies, supplying gas to local consumers on demand and is engaged in a local business. This opinion of the Commission was supported by finding 5 of the Court below as follows:

"Except for qualifying shares, the common stock of the distributing companies is owned by the Gas Service Company, the stock of which in turn is owned by the Cities Service Company. The common stock of the Cities Service Gas Company is owned by the Empire Gas & Fuel Company, the voting stock of which in turn is owned by the Cities Service Company. The Empire Gas & Fuel Company has a preferred stock issue outstanding in the hands of the public. Henry L. Doherty & Company is Henry L. Doherty, who owns thirty five per cent of the voting stock of the Cities Service Company. The Cities Service Company, by stock ownership, legally controls the policies of the distributing companies and the pipe line company; and Henry L. Doherty in fact controls the policies of the Cities Service Company. The distributing companies do not deal at arm's length with either the Cities Serv-

for the Company or Henry L. Doherty & Company." (R. 205)

It is a well settled rule of law that a state does have power to regulate the price of gas brought into a state and sold directly to consumers because, "the business of supplying on demand local consumers is a local business, even though the gas be brought from another state and drawn for distribution directly from interstate mains, and this is so whether the local distribution be made by the transporting company or by independent distributing companies." (Missouri v. Kansas Gas Co., 265 U. S. 298; Penn Gas Co. v. Pub. Ser. Com., 252 U. S. 23; East Ohio Gas Co. v. Tax Com., 283 U. S. 465.)

It necessarily follows that the Commission had the power to determine the reasonableness of the charges set up as operating expense for gas at the city gates in fixing the local rates. This was done by determining a reasonable return to the Cities Service Gas Company for producing, transporting and delivering such gas at the city gates. The reasonable return was determined by arriving at the value of the property of the Cities Service Gas Company, used and useful, in the business of producing, transporting and delivering gas, the amount of its net earnings and a fair return upon such property.

The alternative, should it be conceded for the purpose of argument that the Commission could only scrutinize and inquire into the reasonableness of such charges

was well stated by the lower Court in its opinion as follows:

> "However, if we grant that the Commission can only scrutinize and inquire into the reasonableness of such contracts, we are of the opinion that the same result necessarily follows. Since the Cities Service Company enjoys a monopoly and affords the only reliable source for supplying gas to the distributing companies, the only method of determining the fairness and reasonableness of the charge at the city gates is to determine the reasonableness of the return to the Cities Service Gas Company on their property used and useful in the business. Any charge in excess of that for gas at the city gates, under the contract between two subsidiary corporations who have the same parent or holding corporation, would be unfair and unreasonable." (R. 287)

The case was tried before the Commission and before the Court below upon the theory that the reasonableness of the contracts should be determined on the basis of a reasonable return to the Cities Service Gas Company for producing transporting and delivering gas at the city gates, and the facts necessary for such determination were presented.

Counsel for the distributing companies, in his opening statement to the Commission, recognized the propriety of the above test of the reasonableness of the pipe line company's charge for gas at the city gate. The opening statement of counsel for the distributing companies was adopted by The Cities Service Gas Company and attached to its bill of complaint as Exhibit "A". We quote from the statement as follows:

"The question in which the Commission should now be interested, and the only issue which we now recognize in this proceeding as far as the city gate rate is concerned, is as to whether or not *the earnings of the Cities Service Gas Company under the existing city gate rate are more than a fair return on the fair value of its property.*" (R. 234)

Again counsel states:

"On whatever value is shown to exist, the pipe line company is entitled to a fair return. It asks nothing more." (R. 235)

Counsel closed his statement as follows:

"We respectfully decline to voluntarily do anything to cripple our ability to continue such service; nevertheless we recognize now and always that we are entitled to only a fair return on a fair value of our property." (R. 236)

CONTENTION OF CITIES SERVICE GAS COMPANY.

The Cities Service Gas Company is the gas pipe line company which supplies gas to the affiliated distributing companies. The intercorporate relations and the Court's findings thereon have been discussed.

In the hearing before the Commission only the distributing Companies were before it as parties because over them the Commission had direct jurisdiction. In the case before the lower Court the Cities Service Gas Company also filed a petition.

The theory of the pipe line company appears to be that even though the Commission had jurisdiction over the distributing companies and made a valid order which

the distributing companies could not attack, the pipe line company could come in and attack the order.

We do not believe the contention has any weight. It was not given any by the lower Court.

The lower Court found against every contention of the Cities Service Gas Company.

The Court in its finding No. 5 found that:

> "The Cities Service Company, by stock ownership, legally controls the policies of the distributing companies and the pipe line company; and Henry L. Doherty in fact controls the policies of the Cities Service Company. The distributing companies do not deal at arms length with either the Cities Service Gas Company or Henry L. Doherty & Company." (R. 295)

No objections were made and no exceptions were taken to the finding.

The Court in its opinion stated as follows:

> "The Commission had the power to determine the reasonableness of the charge set up as operating expense for gas at the city gates in fixing the local rate." (R. 286-7)

The lower Court sustained the Commission's order as to the payments to Henry L. Doherty & Company, in which the same legal questions were involved. (R. 291) The Cities Service Gas Company took no appeal.

By Exhibit A attached to the pipeline Company's bill of complaint, it is conceded that the distributing Companies and the pipe line Company is controlled by the Cities Service Company.

It is stated in the exhibit:

> "The intent of Cities Service Company in the beginning was to confine its activities to the Pipeline end of the business, leaving the distributing companies in the hands of their then owners entirely unassociated with our organization. *** The large markets, such as the two Kansas Cities, Wichita, Newton, Hutchinson and Topeka were owned by corporations unfriendly to the pipe line ownership and had been antagonists in litigation with it for the preceding ten years. *** In the opinion of the officials of the Company, responsible for adequacy of service by the pipeline, the situation was such as to require ownership of the distributing companies in order to assure a market which would greatly increase investment and which was necessary in order to give proper and adequate service to the consumers." (R. 231 2)

It therefore appears that the Company had two purposes in getting control of the distributing plants. One was to get rid of litigation as to the rate being charged by the pipe line Company. The other was to assure a market. If the owners of the pipe line company had control of the distributing companies they would not be going into other markets for cheaper gas.

F. C. Hamilton, consulting engineer for Henry L. Doherty & Co., also testified that the distributing companies were purchased to get rid of litigation and unfriendly relations between the pipeline company and the distributing companies. (R. 455-6)

The only questions presented by the assigned errors and before the Court on appeal, pertain to the valuation of the property, the net income and the rate of return

as affecting the reasonableness of the Commission's order.

EXPLANATION OF ORDER IN WHICH ASSIGNED ERRORS CONSIDERED.

Assigned errors 1, 2, 3, 4, 21 and 22 go to the findings of the Court below which are general conclusions drawn from its findings of the value of the property used and useful in the business of supplying gas to the affiliated distributing companies, and its findings of net available annual return.

Assigned errors 5, 6, 7, 8, 9, 10, 11, 12 and 13 go to the Court's findings as to value of the property used and useful in the business of supplying gas. All of the lower Court's findings as to value were considered under its finding 14. (R. 302)

Assigned errors 14, 15, 16, 17 go to the lower Court's findings of net available annual return.

Assigned errors 18, 19 go to the lower Court's findings as to necessary rate of return.

In order to present the case in the order of its development, the assigned errors will not be considered in their numerical order. We will first consider those going to value, then those going to the net available annual return, those going to the necessary rate of return, and last, those going to conclusions from the basic findings.

THE VALUATION.

Assigned Errors 5, 6, 7, 8, 9, 10, 11, 12 and 13.

Generally.

The question of valuation was gone into very carefully before the Commission. The Commission heard testimony for twenty-six days and received one hundred and one exhibits. Some of the exhibits contained thousands of pages. There was testimony from forty witnesses and the evidence when finally transcribed consisted of 2,901 pages of testimony.

The chief witnesses who testified in regard to the valuation exhibits were: F. D. Hamilton, Consulting Engineer for Henry L. Doherty & Company, and H. L. Eastman, associated with Mr. Hamilton for the respondent and E. B. Black of the firm of Black & Veatch, Consulting Engineers of Kansas City, Missouri, for the Public Service Commission. For convenience these witnesses will be referred to in the brief as Hamilton, Eastman and Black.

All the engineers based their valuations on reproduction cost less depreciation.

In making its findings the Commission had the benefit of having heard the witnesses testify and observed their demeanor. The case was submitted to the court on the evidence submitted to the Commission and other exhibits. There was no oral testimony presented to the lower court.

In weighing the findings of the court and the Commission it may be helpful to give some consideration to

the methods used by the engineers in preparing the inventory and in the valuation of the property.

Black testified that in making the appraisal or fixing prices he did not use rock bottom prices for labor or material, (R. 374) although it was common knowledge that common labor at the time of the investigation could be obtained at thirty cents or less an hour. Black used forty cents for common labor.

Black in testifying concerning the methods used by him in preparing the inventory and valuation of this property said that he started by requesting the various companies concerned to supply specific information such as maps, plans, construction contracts and all other data having to do with the physical property of the Company; that his engineering forces were organized as rapidly as required to make computations and to check the data furnished by the Company; that engineers were put into the field for the purpose of checking location, kind and condition of such parts of the property as could be checked by physical inspection, and to obtain additional data not contained in the information furnished by the company; that engineers were sent out with the company's inspection crews for the purpose of determining the per cent condition of pipe lines where these crews examined them; that he personally made an inspection of the major part of the territory covered by the liens of the company and that in all approximately 20,000 miles was traveled by his engineers and himself in this inspection and checking, and that from the start of this work, July, 1931, until the final compilation of the valuations

from 8 to 19 engineers were working with him either in the field or checking field data, or compiling quantities.

The data furnished Black by the company consisted of pipe-line maps prepared by the company's own engineering department and which were complete with respect to length of line, size of pipe, weight of pipe and such other data as is required for a record of pipe-line construction, and when the maps did not disclose the data necessary they were supplied by the engineering department of the company. On all major structures, such as compressor station buildings, detail plans were furnished by the company, and where such plans were lacking in detail, additional information was obtained by personal inspection in the field. The company's engineers furnished lists of all machinery in compressor station structures and throughout the system, and this was checked in the field by Black's engineers. In the field survey of structures, Black caused photographs to be taken of practically every structure in the system.

Hamilton in his valuation of many of these accounts, as found by the Commission did not go into detail, but contented himself with a general lumping of the accounts, as is shown by his handling of the following accounts:

In account No. 1310, production field measuring station structures, Black's valuation lists 597 of these structures, 554 of which are carried as individual items, each structure being priced out in accordance with Black's testimony (R. 92-3) by separating structures into classes by sizes and type of construction. Detailed estimates of

materials and costs were determined for each class and the cost then applied on a cubic-foot basis.

Hamilton's structures in this account, while listed by individual structures, were not detailed with respect to methods used in determining the cubic-foot costs applied by him.

Eastman testified (R. 96) with respect to account No. 1311, which testimony was applied also to account No. 1310, that no supporting data for his cubic cost development was available.

In account No. 1315, production field measuring station equipment, Hamilton summarized the items entering into this account by gas fields only, and there is no other detail of this account in Hamilton's exhibits other than the total cost of reproduction of these accounts by fields, except on two pages of his exhibit 17A and B where the number and unit prices of meters in the account are detailed, and the Commission had no supporting data offered, nor could it secure such by examination of Hamilton or Eastman from which these accounts could be checked. (R. 101)

In the case of account No. 1329, transmission measuring station structure, Hamilton shows a total valuation of $165,893 new and $155,018 depreciated. This account is shown only by total dollars by states, no detail being given as to the number of structures and no testimony being offered by any of the company's witnesses concerning such totals. (R. 112)

On the other hand, in Black's appraisal in the preparation of unit prices to apply to various units of property,

all items were built up by addition of direct structural overheads applied to labor and materials.

The prices of valves and fittings were determined by discounts from manufacturers' lists, and the prices of pipe were determined by quotations from the manufacturers f.o.b. the mill, or the application of differentials, and the freight to the point of destination added.

Mr. Black introduced as exhibit 42 a unit cost analysis covering 440 pages showing in detail the development of direct structural overheads, of pipe prices, labor, installation prices and prices for various valves and fittings entering into this construction. He also supplied any additional data requested by the company's attorneys and gave a complete breakdown of all unit prices, for materials or labor, as requested. Exhibit 42 and his additional testimony, both on direct and cross-examination, discloses the detail whereby the unit costs used by him were built up, and it is not necessary to go outside the record to obtain all of the detail used by him in obtaining his unit costs. (R. 115)

On the other hand, although the witnesses for the Company had available the complete records of the Company and they could have furnished all details, with respect to the physical items, costs and amount of labor used by them in the development of the company's unit costs, nevertheless, in no case did the company's witnesses give any breakdown of unit costs used by them in determining the value of this property, except in a few cases of pipe-line construction. Their testimony was that they could not go beyond the unit costs shown

in the appraisal, because as they claimed, the supporting data were too voluminous to bring into the hearing room, and no supporting detail from which unit prices were developed or by which they could be tested was ever produced on the original hearing before the Commission, but on rehearing before the Commission an exhibit containing several thousand pages was introduced, purporting to show such breakdown.

Both Black and Hamilton have followed the same classification of accounts, but it is possible that some property classified by Black under account 1314, production field-line equipment, may have been classified by Hamilton under account 1333, transmission line equipment, or vice versa. Black classifies certain rights of way under account 1307, production rights of way, whereas Hamilton places all rights of way under account 1327 transmission rights of way. Both engineers worked with approximately the same inventory of property items, and it is apparent all property has been included by both, in some classifications.

The following summary is a classification of accounts by account number and description except that no account numbers appear for the last seven items. This summary also shows the value as found by the Court and the Commission for the various accounts.

In order that controverted items may be readily ascertained from the summary we have, where the Court's and Commission's findings were the same as to value, indicated the agreement by inserting Id under the Commission's value.

SUMMARY OF COURT'S AND COMMISSION'S FINDINGS AS TO DEPRECIATED VALUE.

Acct. No.	Title of Account	Court	Commission
1307	Production—Right of way	$ 64,778	$ 55,982
1327	Transmission—Right of way	1,915,427	1,657,530
1310	Production—Field measuring station structures	35,909	Id.
1311	Production—Other Structures	47,876	Id.
1312	Production—Gas Well Construction	1,294,710	1,153,157
1313	Production—Gas Well Equipment	658,439	Id.
1314	Production—Field Line Equipment	3,523,176	3,126,159
1315	Production—Field measuring station equipment	265,746	Id.
1332	Transmission—Measuring station equipment	759,625	Id.
1316	Production—Drilling and cleaning equipment	27,908	Id.
1317	Production—Other Equipment	1,333	Id.
1325	Transmission—Land	147,202	145,202
1328	Transmission—Compressing Station Structures	1,515,662	1,466,102
1329	Transmission—Measuring Station Structure	133,310	Id.
1330	Transmission—Other Structures	113,341	Id.
1331	Transmission—Compressing Station Equipment	8,463,835	8,048,910
1333	Transmission—Line Equipment	40,232,331	39,432,331
1334	Transmission—Other Equipment	5,633	Id.
1376	General—Other Land	3,655	Id.
1379	General—Other Structures	94,687	Id.
1380	General—Office Equipment	106,035	Id.
1381	General—Store Equipment	1,805	Id.
1382	General—Shop Equipment	23,084	Id.
1383	General—Stable Equipment	568	Id.
1384	General—Garage Equipment	81,448	Id.
1385	General—Laboratory Equipment	8,202	Id.
1386	General—Telephone and Telegraph System	415,070	Id.
1387	General—Tools and Implements	44,979	Id.
1388	General—Other Equipment	21,832	Id.
	Engineering and Superintendence during construction	3,321,250	2,881,000
	Preliminary and Organization Expense	500,625	480,008
	Administration and Legal Expense during construction	350,350	304,084
	Miscellaneous Construction Expenditures	700,700	608,169
	Taxes during Construction	875,171	778,044
	Interest during Construction	4,471,934	3,883,282
	Working Capital	775,000	Id.
	Materials and Supplies	628,675	Id.
	Gas in Line	22,000	Id.
	Going Concern Value	5,000,000	2,000,000
	Gas Leases	5,727,272	2,874,390
	Rate Base	$82,380,583	$73,170,510

The court increased the total depreciated value as found by the Commission $9,210,073.00.

At the risk of repetition it is believed that it will be helpful to insert here a brief summary of the difference between the Court's and the Commission's findings of value as to the disputed items.

Summary of Disputed Accounts.

1307. PRODUCTION—RIGHT OF WAY.
1327. TRANSMISSION—RIGHT OF WAY.

The Court found that twenty-two cents per rod should be added to the Commission's cost of obtaining rights of way. The Court therefore added twenty-two cents per rod to 39,987 rods of right of way which Black placed under account 1307, increasing the Commission's value $8,796.00.

For transmission rights of way the Court also added 22 cents per rod, but through error computed the same on 1,172,284 rods instead of the agreed figure of 1,114,115 rods. The Court's increase over the Commission's value of this item therefore should have been stated as $249,100 instead of $257,897.

The value placed on the 65,440 rods of telephone right of way was not changed.

1312. PRODUCTION—GAS WELL CONSTRUCTION.

The Court considered 1312 jointly with account 1313 and added to account 1312, $57,235.00 on account of storage wells and $84,318.00 on account of its findings

as to cost of construction, increasing the Commission's value of account 1312, $141,553.00.

1314. PRODUCTION—FIELD LINE EQUIPMENT.

The Court added $397,017.00 to this account because of Black's assumption that field lines were buried only one-half the depth of main lines and therefore the ditching was less expensive.

1325. TRANSMISSION—LAND

The Court found the Hogshooter compressor station used and useful and added $2,000 to the Commission's value for the land.

1328. TRANSMISSION—COMPRESSOR STATION STRUCTURES.

For the same reason mentioned in account 1325, the court added the value of the structure of the Hogshooter compressor station in the amount of $49,560.00.

1331. TRANSMISSION—COMPRESSOR STATION EQUIPMENT.

For the same reason mentioned in account 1325 the court added the equipment at the Hogshooter compressor station in the amount of $414,925.00.

1333. TRANSMISSION—LINE EQUIPMENT.

Without any detailed mathematical calculations the court added $800,000.00 to the Commission's findings as to the value of this account on the basis that the Commission's allowance for the amount of rock excavation was too low as shown by the re-survey made after the

hearing before the Commission. The Court adopted the Commission's findings as to cost of rock excavation but increased the amount of rock to be excavated.

ENGINEERING AND SUPERINTENDENCE DURING CONSTRUCTION.

The Court added $440,250.00 to the Commission's finding as to the value of this account. The Court arrived at the value by applying 5% to the properties except certain items of general equipment as agreed to by the parties. The Commission depreciated this account $337,585.00. The parties have stipulated that overheads should not be depreciated and that no annual allowance for depreciation on overheads should be made. There remains a difference of $102,665 which is accounted for by the fact the Court increased the value to which the percentage was applied.

PRELIMINARY AND ORGANIZATION EXPENSE.

The Court adopted the Commission's finding of ¾ per cent of the value of the physical property but added $20,617.00 because it increased the value of the physical property. The Commission did not depreciate this account.

ADMINISTRATION AND LEGAL EXPENSE DURING CONSTRUCTION.

The Court adopted the Commission's finding of one-half of one per cent of the value of the physical property but added $36,010.00 because the Commission depreciated the account, and $10,256.00 because it increased

the value of the physical property, making a total addition of $46,266.00.

MISCELLANEOUS CONSTRUCTION EXPENSE.

The Court adopted the Commission's finding of one per cent of the value of the physical property but added $72,018.00 because the Commission depreciated the account and added $20,513 because it increased the value of the physical property, making a total addition of $92,531.

TAXES DURING CONSTRUCTION.

The Court adopted the Commission's finding as to this account but used the reproduction new value instead of deducting depreciation, making a difference of $97,127.00.

INTEREST DURING CONSTRUCTION.

The Court adopted the Commission's allowance of 6 per cent but added $468,652.00 because the Commission depreciated the item and $120,000 because it increased the value of the property.

GOING CONCERN VALUE.

The Court added $3,000,000.00 to the Commission's finding as to going concern value.

GAS LEASES.

The Court added $2,852,882 to the Commission's value of gas leases including all leases owned by the Company at cost, regardless of their developed, proven, probable or prospective character.

Presumption and Burden of Proof.

We are mindful of the fact that on the question of confiscation, the plaintiffs below are entitled to an independent judgment as to the law and facts, but in determining these facts, we are of the opinion that the findings of the Commission are presumed to be correct and that the burden is upon the plaintiffs to overcome this presumption. (Blanton v. Belt Line Ry. Corp., 268 U. S. 413, 422; Cotting v. Kansas City Stock Yards Co., 183 U. S. 79; Denver Union Stock Yards Co. v. U. S., 57 Fed. 2d, 735; Los Angeles G. & E. Corp. v. Railroad Commission, 289 U. S. 287, 77 L. ed. 820.)

In weighing the evidence as between the lower Court's and the Commission's findings, it must be kept in mind that the evidence submitted to the lower Court consisted almost entirely of the transcript of the evidence submitted to the Commission, and that the Commission and not the lower Court was the fact finding tribunal which had the opportunity to hear the witnesses testify. There was no oral testimony before the lower Court.

In our following discussion of the facts pertaining to the valuation, we are of the opinion that in no case was the evidence before the lower Court nor is the evidence before this Court, sufficient to overcome the presumptions of the correctness of the Commission's findings.

Accrued Depreciation.

There was no material controversy as to the Commission's finding on accrued depreciation except as to account 1333, transmission—line equipment. The lower

Court disposed of this controversy with the following statement:

> "The Commission found the property to be in 90.1 per cent condition. The Company asserted it to be in 92.93 per cent condition. The Commission's finding is supported by the testimony of its engineer and a consulting engineer called by the Company. We approve the Commission's findings as to per cent condition." (R. 307)

The appellees accepted the Court's finding and there is no controversy as to accrued depreciation on appeal. (R. 416)

Discussion of Disputed Accounts.

The disputed accounts will be discussed in the order in which they appear above.

Assigned Error No. 7.

1307 Production—Rights of Way.
1327 Transmission—Rights of Way.

These two accounts cover rights of way for production and transmission lines and telephone lines used in connection therewith. The two accounts have been treated together for the reason that some controversy has arisen as to how the respective engineers classified particular lines as between production and transmission.

There are in the system 65,440 rods of telephone rights of way which the Commission's engineer Black, priced at 25 cents per rod and the Company's engineer Hamilton, at 15 and 20 cents per rod. There is included in Black's valuation $16,360 for telephone rights of way

and in Hamilton's valuation $12,475. The Commission adopted Black's value for telephone rights of way and there is no controversy as to this item.

As to the number of rods of pipe line rights of way involved in the two accounts, Black calculated 1,212,251 and Hamilton calculated 1,180,102. Black computed his rodage from maps furnished by the Companies, which in error, did not show that certain lines had been reclaimed and abandoned, and the rodage as calculated by Hamilton is correct. (R. 396).

Black testified that the figures used by him in finding the value of rights of way were the result of information procured by his organization from other pipeline companies operating similar lines. The unit costs developed by him were 85 cents per rod on pipe lines under 16 inch and $1.20 per rod for lines of 16 inch and over. (R. 396) His average total cost for all rights of way was $0.997 per rod.

The Company divided the system in nine groups in arriving at the cost of rights of way. The cost per rod in the various groups ranged from $2.11 to $3.54. (R. 397)

The breakdown of the unit price for the group calculated at $3.54 per rod is as follows:

Aerial Surveys	$ .10	per rod
Field Surveys in Staking the Route of the Line	.19	" "
Right of Way Payments for Purchase of Easements from Land Owners	1.25	" "
Crop Damage and Damage to Fences and Trees	.70	" "
Expense of Obtaining Right of Way Agreements	.30	" "
Abstract and Recording of Rights of Way Agreements	.10	" "
Miscellaneous Expense	.10	" "
Clearing, Grading and Fencing	.80	" "
	$3.54	" "

The same items were considered in the breakdown of the other groups but the price applied per unit was less. (R. 397)

It immediately appeared that four of the items were improperly included in the cost of rights of way. They will be discussed separately in the next four paragraphs following.

The cost of Aerial Survey was improperly included because the system was built without it and the advantages were not reflected. (R. 404-5)

The cost of Field Surveys in Staking the Route of the Line was improperly included because both engineers made the allowance under the general account of Engineering and Superintendence by calculating engineering on all the physical property accounts including the ac-

counts covering right of way. To place engineering under rights of way and again under the general account of engineering would be a duplication.

Miscellaneous Expense was improperly included because it was simply thrown in as a possible expenditure with no evidence to support it, and for the additional reason that it was already included under the general account Miscellaneous Construction Expenditures. Miscellaneous Construction Expenditures was calculated on all physical property accounts, including the accounts covering rights of way. To place it under the account for the cost of rights of way and again under the general account for Miscellaneous Construction Expenditures would be a duplication.

The cost of Clearing, Grading and Fencing was improperly included because it is not part of the acquisition cost of rights of way but enters into the cost of construction. Black included the cost of clearing, grading and construction damages under the general construction accounts and there it was allowed by both the lower Court and the Commission. (R. 403-4) Construction contracts were introduced which showed that under the practice of the Company cost of clearing rights of way, etc., was included in the construction contract as part of the construction cost as calculated by Black. (R. 403)

The elimination of the four items just discussed from the Company's right of way cost was approved by the lower Court in the following language:

> "The Company's figure of around $3.00 includes aerial surveys, which were not used, and if used,

> probably would have been worth their cost in a saving not reflected in its present valuation. Apparently the Company also included certain construction costs elsewhere accounted for." (R. 304)

The Commission, in arriving at a value to be placed on rights of way was confronted with the following problem:

Two engineers of national reputation and high standing had presented to the Commission a value to be placed upon rights of way with a difference in their judgment ranging from 85 cents to $3.54 per rod, and the calculations of one engineer containing many apparent improper items.

The Commission then had its accountant, Clinton H. Montgomery, who had made an audit of the books of the Company, prepare an exhibit showing the actual cost of the right of way to the Company.

Montgomery testified that he made an audit of the books of the Company covering 6,215,512 feet of pipe line and that,

> "The rights of way and damage costs totaled $407,179.82 or an average of $1.08 per rod; that the number of rods included in his audit totaled 376,698 or 31 per cent of the total rods included in accounts 1307 and 1327. [The entire system.] (R. 397)

A large part of the system was constructed before the system was acquired by the present Company and its books therefore did not reflect the original cost as to that part.

The 31 per cent reported on by Montgomery was ac-

quired by the present Company during the peak of high prices and the figure of $1.08 per rod should have reflected the highest acquisition cost of the Company.

The Company contended that all the elements of the cost of acquisition of rights of way was not reflected in the figure of $1.08 per rod as shown by the books of the Company. An engineer for the Company testified:

> "The costs of right of way as shown in Exhibit No. 87 are not the entire costs of a right of way on the various lines. As I explained some few days ago, at a previous hearing, these costs include nothing for the acquisition of right of way, which is a major item.
>
> Q. What do you mean by costs of acquisition of right of way?
>
> A. Going out and securing right of way, having it abstracted and recorded.
>
> Q. That is, it does not include the expense of men in the field, the automobiles, phone calls and all that?
>
> A. No, sir; it does not." (R. 402)

The Commission then gave to the exhibit showing the book cost, the most favorable interpretation that could be given to the Company, that was, that none of the costs of rights of way were included in the figures of $1.08 as reflected by the books of the Company, except Rights of way Payments for Purchase of Easements from Land Owners, and Crops Damages and Damages to Fences and Trees. These two items were necessarily reflected in the book cost, if the book cost meant anything, as it was an original cost for the acquisition of rights of way and could pertain to no other property account.

The Commission then eliminated from the items set out by the Company's engineer in making up the rights of way costs, Aerial Surveys, Field Surveys in Establishing Route of Line, Miscellaneous Expenses, and Clearing, Grading and Fencing for the reasons already set out, and allowed items for the cost of rights of way as follows:

Rights of Way Payments for Purchase of Easement, Crop Damage and Damage to Fences and Trees	$ 1.08 per rod
Expense of Obtaining Rights of Way Agreements	.22 " "
Abstracting and Recording	.10 " "
Total	$1.40 " "

In this allowance, the Commission used the book cost for the first two items; used the cost testified to by the Company's witness Hicks for the expense of obtaining rights of way, and used the cost testified to by the Company's engineer for abstracting and recording rights of way agreements.

The Court added 22 cents to the Commission's cost of rights of way, which increased Account No. 1307 $8,796 and increased Account No. 1327 $257,887. The Court stated its reasons therefor as follows:

> "The Commission allowed $1.40 a road for rights of way. It used $1.08 as a basis, that figure being the average cost as shown by the books of the Company of 31 per cent of its rights of way. To this,

the Commission added 22 cents per rod for expense of acquisition and 10 cents per rod for abstracting and recording fees. The evidence clearly developed that the figure of $1.08 did not purport to represent all of the costs and is not a dependable figure. The most dependable evidence is that of a man who negotiated for these rights of way during the past four years. His offering price to all land owners was 50 cents per rod for land and 50 per rod for damages; sometimes he paid as much as $2.00 per rod for land alone; the average damage paid was 65 cents. He did not state the average cost for the land, but it can not be assumed that he acquired all of it at his offering price. It should not be figured lower than 65 cents, the average paid for damage for which his offer was likewise 50 cents. These items make $1.30 per rod paid the land owners, adding to that the 32 cents allowed by the Commission for overhead gives a figure of $1.62, which we have used." (R. 304)

We believe that the lower Court misconstrued the evidence when it found that "the evidence clearly developed that the figure of $1.08 did not purport to represent all of the costs and is not a dependable figure."

It was conceded by the Commission and all parties from the evidence submitted by the Company, that the figure of $1.08 did not purport to represent all of the costs.

The Commission in its findings conceded that it represented none of the overhead costs and for that reason the Commission added to the figure, the cost of Abstracting and Recording Right of Way Agreements and The Expense of Obtaining Rights of Way. The other four items which the Company contended were not included

in the figure of $1.08 were eliminated by the Commission for the reasons already stated.

The lower Court and the Commission are in accord as to the items which should be allowed in the costs. The only conflict therefor remaining between the findings of the Commission and those of the lower Court goes to the figure of $1.08, which makes up the cost of rights of way Payments for Purchasing of Easements and the Cost of Crop Damage and Damage to Fences and Trees.

The Court added to these two items, which the Commission calculated at $1.08, 22 cents, making a total of $1.30 for the two items, stating that:

> "The most dependable evidence is that of the man who negotiated for these rights of way during the past four years. His offering price to all land owners was 50 cents per rod for land and 50 cents per rod for damages; sometimes he paid as much as $2.00 per rod for the land alone. The average damage paid was 65 cents." (R. 304)

With this statement of the Court, we cannot agree. We believe that the most dependable evidence is the actual cost as shown by the books of the Company, and if the estimates made by the man who acquired the rights of way and his oral testimony pertaining thereto conflict with the actual cost figure as shown by the books of the Company, the most dependable evidence is the actual cost shown by the books and not the estimate made by the field man. This appears to us to be in accordance with the lower Court's findings on other

items that estimates and assumptions cannot stand against the actual facts.

In our opinion the lower Court made a mistaken analysis of the testimony as to what costs were not included in the figure $1.08 when it concluded that the figure should be raised to $1.30.

The lower Court, in support of its figure of $1.30, in Finding 14, referred to the testimony of the man who negotiated for the rights of way during the past four years, (Hicks), "That the average damage paid was 65 cents," and then while admitting that the witness did not state the average cost for the land contented itself by asserting that it should not be figured lower than 65 cents and then proceeded to add the two figures, proclaim the result of the addition as being $1.30 and conclude that the land owner was paid such sum.

We respectfully submit that the evidence does not justify an increase of the Commission's finding as to the cost of acquiring rights-of way, and the value pertaining to these two accounts in the amount of $55,982 for Account No. 1307 and $1,657,530 for Account No. 1327.

Assigned Error No. 8.

1312 Production Gas Well Construction.
1313 Production Gas Well Equipment.

The lower Court discussed these two accounts together in its Finding No. 14, and the same procedure will be followed here.

Account No. 1312, Production Gas Well Construction, covers all costs of drilling gas wells and the placing in the wells of all casing, tubing and equipment furnished by the owner. The number of wells, location and the items entering into the account were taken by Black from an inventory furnished by the Company. (R. 96)

Account No. 1313, Production Gas Well Equipment, covers all casing, tubing and fittings going into the wells.

The evidence pertaining to these accounts will be found on pages 377 to 388 of the record.

The lower Court added $141,553 to this joint account, covering $57,235 which the Commission had deducted for so-called storage wells in the Augusta and Craig fields, and $84,318 growing out of the cost of other gas well construction. No addition was made directly to Account No. 1313.

The following table shows the findings by the Commission and the lower Court and the increase made by the lower Court:

Acct. No.	Title of Account	Court	Commission	Increase
1312	Production—Gas Well Construction	$1,294,710	$1,153,157	$141,553
1313	Production—Gas Well Equipment	$ 658,439	$ 658,439	None
	Total Increase			$141,553

We will first consider the addition made by the Court in the amount of $57,235 growing out of the allowance in the valuation of the so-called storage wells in the Craig and Augusta fields. The wells are ones which were formerly drilled for gas and were abandoned after the gas was exhausted. The record shows that the re-

spondents had two fields which they used for storage, one known as the Craig field and the other as the Augusta field. These fields are used as a reservoir into which gas is placed during the summer months when the demand for gas is low, as a reserve to be used during cold weather when the demand is greater. The record shows that the Company, after the gas in the Craig field was exhausted, or depleated to such an extent that production was not profitable, entered into contracts with the land owners whereby they leased these lands containing the abandoned wells for storage purposes. There were 19 of the wells in the Augusta field and 47 in the Craig field. The wells were given a depreciated value of $57,235.

From the evidence introduced before the Commission, it found that the abandoned wells (referring to the hole only), belonged to the land owners and not to the Company and that they were simply leased to the Company for the purpose mentioned in the storage contract and that the Company had no title to them and had no investment in the Craig field wells, and that they should not be included in the valuation of the pipe line company's property. On the basis of this finding, the Commission eliminated the value placed upon the holes from the rate base.

At the hearing before the lower Court, the Company introduced additional evidence which showed that in the Craig field the Company obtained the right to use the abandoned gas wells from the land owners under a stor-

nge contract, which provided that it was to be placed in escrow until the commencement of operation and until the payment of $10 per acre and the payment of his share of the recoverable gas remaining in the storage strata. In connection with this evidence, the Court found:

> "It is not denied that the wells are properly used for storage and for a public purpose; the claim is that the land owner has the property interest in the hole in the ground. Upon the trial before this Court, it was conclusively proven that the Company has entered into gas leases with royalties paid in advance for the use of these wells. Its rights thereto are the same as in producting leases. The assumption of fact made by the Commission is erroneous. The legal conclusion need not be examined." (R. 305)

As yet there are no storage contracts in the Augusta field. The wells there are being used for storage without cost to the Company. These wells are depleated and the Company has already had returned to it, the cost of the hole through amoritization. It might be said as to the storage wells in both the Craig and Augusta fields, that they were worthless when acquired by the Company for other than storage purposes, and nothing was paid the owner for the value of the wells. They were only leased. The only consideration which passed was an annual rent for the use of the field for storage purposes plus a consideration for any immaterial amount of gas that remained in the field. If the wells cost the Company nothing at the time the storage contracts were acquired, it is not reasonable to assume

that the holes would have to be purchased if the pipe line system were reproduced.

The other increase made by the Court in this account may be set out in its own language as follows:

> "The other item is $84,318 growing out of the cost of gas well construction. The Company's figures were considerable below actual cost and below the cost of adjacent wells drilled by other companies of the same depth. The engineer for the Commission omitted certain items in his calculations which may account for his figures being so much below the actual cost of construction. The Commission's figures are so far below the cost of these wells or any other well in the vicinity that they approach the arbitrary." (R. 305)

As to the Court's statement that "the engineer for the Commission omitted certain items in his calculations which may account for his figures being so much below the actual cost of construction", we believe the Court misunderstood the facts pertaining to the situation. In Account No. 1313 pertaining to Gas Well Equipment, Black used the same price for casing and tubing in these wells that he used for the main line pipe of the same weight and size. It was conclusively established that casing and tubing must be purchased from local warehouses and not from wholesale houses as was the pipe in the main line and that therefore a higher price must be applied. For that reason the Commission accepted Hamilton's total price of $853,309 for casing and tubing, corrected for overheads, and eliminated any controversy as to this item. There is no other evidence in the record of the omission of any items. In fact, the record

shows that the number of wells, location and items entering into construction were taken by Black from an inventory furnished by the Company. (R. 96)

The record contains the agreed statement that:

> "To Black's figure for Account No. 1313, the Commission added $236,373 new and $173,925 depreciated because the prices Black applied to casing and tubing in the wells was considered insufficient." (R. 378)

The record further discloses by agreement that if the controversy as to storage wells is eliminated from the accounts the difference between Hamilton's depreciated value and that found by the Commission is but $84,318. (R. 379)

The value of these two accounts amounted to $2,483,068 new and $1,811,596 depreciated, and there was only $84,318 difference between the value placed upon them by the Company and the Commission. Yet the Court finds that, "the Commission's figures are so far below the cost of these wells or any other wells in the vicinity as to approach the arbitrary." (R. 305) Such a conclusion is not possible. The Court was evidently confused by some comparisons made by the Company as to values placed upon the construction by the Commission's engineer before the price of casing and tubing was adjusted by the Commission. In fact, when the adjustments were made the Commission practically conceded to the Company the full value it asked for the account.

The Company owns 304 wells which divided into the difference in value found by the Commission and the Company, amounts to but $275 per well for construction

and equipment. When the cost of these wells, which ranged from $3,000 to over $30,000 each, is considered, a difference between the value found by the Court and as found by the Commission, of approximately $275 per well, can hardly be said to approach the arbitrary. The slight deduction made by the Commission from the Company's value was largely due to the adjustment in overheads which appear justified by the evidence, with nothing in the record to the contrary.

We do not believe it necessary to burden the Court with a lengthy review of the evidence pertaining to these accounts. It is apparent that the lower Court was confused in its reason for making the addition, and in its suggestion that the Commission's finding approached the arbitrary.

Assigned Error No. 9.

1314 Production—Field Line Equipment.

This account covers the labor and materials necessary to construct and test pipe lines between the wells and transmission system. The evidence pertaining to this account will be found on pages 388 to 395 of the record.

There was a disagreement between the engineers for the Commission and the Companies as to the price of pipe going into this account. The Commission eliminated this controversy by adjusting the price of pipe and there was no dispute as to the pipe price before the Court below. The controversy before the Court below consisted of the cost of labor and construction—largely that of

ditching and back filling. The Commission found the value of this account new to be $3,548,102 and the depreciated value to be $3,126,159. The Court added $397,017 to the Commission's depreciated value, stating its reasons as follows:

> "The Commission adopted Mr. Black's estimate, which was based on assumption that field lines were buried on the average to one-half the depth of main lines. The Company's value was based upon the facts. Black testified his figures would have been more accurate if he had had time to gather the facts. It clearly appears also that field lines are more expensive to construct than main lines; they are in smaller units; more hand labor is involved; and more connections are necessary; also the cost of field lines cannot be decreased by taking advantage of the topography as may generally be done with main lines. The Company's figures are strongly buttressed by an analysis of actual cost of field lines utilizing 20,600 tons of pipe. The assumptions of the Commission and its engineer cannot stand against the facts." (R. 305-6)

It is our opinion that the Court, in basing its finding on the criticism of Black's assumption without considering the facts from which the assumption was made, arrived at an entirely erroneous conclusion.

It will be noted that the assumption only went to the amount of ditching and back filling of field lines.

In pricing this account, Black testified that all field lines in Texas up to and including 4 inch, were priced on the assumption that they were buried at one-half the depth of the main line and that in other states field lines up to and including 10 and ¾ inch were assumed as

being placed in trenching one-half the depth of the main line of the same size, and that ditching and back filling was included on the basis of half depths on all lines in consideration of the fact that approximately 872,000 feet of field line are above the ground. (R. 388)

It must first be noted from the statement above that Black only considered lines of 4 inch or under as field lines for the purpose of estimating ditching and back filling in the Texas field. This field is the largest that the Company has. All field lines greater than 4 inch were considered as buried the full depth. After having eliminated all field lines over the size mentioned above for the purpose of calculating trenching at one-half the depth of main lines and considering the fact that 872,000 feet of field lines are above ground, Black's assumption was no doubt correct.

However, we do not need to bore the Court with a detailed discussion of the manner in which Black arrived at his conclusion that field lines should be calculated at one-half the depth of main lines to justify the correctness of his assumption.

If Black's assumption is supported by the findings of the Company's engineers, certainly they are in no position to attack it. If Black's assumption resulted in a figure higher than that asked for by the Company, certainly it is in no position to attack Black's figure. This is the case. The evidence discloses that Black's assumption was in the Company's favor rather than against it, and if the Court made any correction, it should have decreased the allowance rather than increased it.

This is shown by calculating the excavations of field lines allowed by Black and Eastman from their respective exhibits. Black allowed 283,386 cubic yards of earth excavation and 45,389 cubic yards of rock excavation, a total of 328,775 cubic yards. Eastman allowed 261,580 cubic yards of earth excavation, and 44,293 cubic yards of rock excavation, a total of 305,873 cubic yards.

It necessarily results that Black allowed 21,806 cubic yards of earth excavation more than Eastman and 1,096 yards more of classified rock excavation than did Eastman. If Black's assumption, fallacious or otherwise, resulted in an allowance to the Company of 21,806 cubic yards of dirt excavation and 1,096 cubic yards of classified rock excavation more than it asked for and this was allowed by the Commission, we cannot see how the appellees were hurt by Black's assumption, neither do we see how the Court was justified in increasing the Commission's allowance where the assumption resulted in a benefit to the appellees. If the Court made any adjustment because it felt the assumption was erroneous and it desired to accept the Company's figures because the Company's figures were based upon the facts, then the Commission's allowance should have been decreased rather than increased.

The difference between Black's valuation of this account and the valuation of the appellee's engineer, was not due to the fact that Black figured his excavation and back filling for field lines at one-half the depth of the main lines, but rather was due to labor costs after the amount of ditching and back filling was ascertained.

Black's cost for both earth and classified rock excavation was approved and used by the lower Court. In discussing Black's price for classified rock excavation under Account No. 1333 which was the same price used by Black for his classified rock excavation under Account No. 1314, the Court said:

> "Applying Black's price to an increased amount indicated by the test, results in an increase of this item *** ". (R. 308)

Neither did the Court in Account No. 1333 disturb Black's price for earth excavation.

We therefore submit that having approved Black's prices, the Court should have either accepted Black's figures as to the amount of ditching and back filling on field lines, or it should have applied Black's prices which it approved to the amount of ditching and back filling found by the Company, which would have resulted in a reduction of the value of the account instead of an increase of $397,017.00 as found by the Court.

Assigned Error No. 10.

1325 Transmission Land.
1328 Compressor Station Structures.
1331 Compressor Station Equipment.

The Court increased the valuation found by the Commission for Account No. 1325 Transmission Land $2,000.00, Account No. 1328 Compressor Station Structures $49,560.00, Account 1331 Compressor Station Equipment $414,925.00. (Finding No. 14, R. 306)

These represent the value of the land, structure and

equipment of the Compressor Station at Hogshooter, Oklahoma, and should not be added to the valuation of these accounts as found by the Commission, unless the Commission was not justified in its determination that Hogshooter Station was not in use and was abandoned.

Counsel for the State contend that the evidence supports the Finding of the Commission that the Hogshooter Station was not in use, and was abandoned on September 1, 1931, and that it was error for the Court to increase these accounts.

The evidence shows that the Hogshooter Station was not in use on September 1, 1931, the date of the valuation, but was then abandoned and had been abandoned probably for five years and has contributed nothing to the earnings of the system during the period covered by the investigation; that this station had been constructed in 1909, and was acquired by the Company when it took over the old Kansas Natural property; that the gas field it was intended to serve had become exhausted; that the lines to this Station were coupled with the old style dresser coupling, not capable of withstanding the high pressure under which the Company now operates. It is true that on February 3, 1932, Mr. Eastman testified that the Hogshooter Station was at that time useful to the Company and that it was the intention of the Company to weld the 18 inch line extending north from this Station so that it would be capable of carrying high pressures, and that a requisition for that work had been prepared, and that when

this was done the Station would be capable of use; however, the testimony also showed that on February 3, 1931, the Company made a tax return to the Oklahoma Tax Commission, with reference to this Station, stating for the purpose of obtaining a reduction of its taxes:

> It "is now and has been abandoned for several years. This property is now subject to sale and reclaim and has only a junk or salvage value of not to exceed $5,000.00." (R. 406)

In view of all of this testimony, we submit that the finding of the Commission that this Station was not in use and abandoned, should be sustained and that the finding of the Court as to these three accounts should be diminished by the said amounts added for the value of the land, structure and equipment of the Hogshooter Station.

Assigned Error No. 11.

1333 Transmission—Line Equipment.

This account covers the transmission pipe line of the Cities Service Gas Company in place, including both material and labor. The evidence pertaining to this account will be found on pages 415 to 443 of the record.

The Commission found the reproduction cost new of this account to be $43,746,298, and the reproduction cost new less depreciation to be $39,432,331.

Without any detailed mathematical calculation, the Court added $800,000 to the Commission's finding as to the depreciated value of this account on the basis that

the Commission's allowance for the amount of rock excavation was too low as shown by the resurvey made after the hearing before the Commission.

This account made up approximately half of the total valuation of the properties in dispute. At the hearing before the Commission there was a dispute between the engineers pertaining to this account on the price of pipe, the percentage condition of the property, the price to be applied to rock excavation, and the amount of rock excavation in the system. The Commission eliminated the dispute as to the price of pipe by adding $589,960 to Black's price of pipe. It was agreed by the parties before the District Court that:

> "The addition of $589,960 made by the Commission to the value found by Black covers pipe and paint, the Commission having found the value of the pipe in the system to be $26,931,305, which for the purpose of this case will be accepted by the parties." (R. 415)

As to the remaining disputes pertaining to this account, it was agreed by the parties before the District Court as follows:

> "The remaining difference between the value for the entire account as found by the Commission and that as claimed by Hamilton, is accounted for by the difference in percent condition found by Black and adopted by the Commission, and the percent condition claimed by Hamilton and by the difference in estimates by Black and Hamilton as to the amount of rock excavation in the system and the price to be applied to such rock excavation." (R. 416)

The Court disposed of the controversy existing as to the per cent condition as follows:

> "The Commission found the property to be in 90.1 per cent condition. The Company asserts it to be in 92.93 per cent condition. The Commission's finding is supported by the testimony of its engineer and a consulting engineer called by the Company. We approve the Commission's finding as to per cent condition." (R. 307)

The Court also adopted Black's excavation prices and applied them to the amount of rock excavation.

It has been agreed by the parties, for the purpose of this appeal, as follows:

> "For the purpose of this appeal, the parties have agreed to accept per cent condition found by the Court and the unit cost which the Court found should be applied to rock excavation, leaving in dispute only the amount of rock excavation to which the agreed price should be applied." (R. 416)

Therefore, the only controversy pertaining to this account remaining for discussion is the amount of rock excavation. Black used a price of $2.50 per cubic yard for classified rock excavation, which included both pick and shoot rock. (R. 438) Eastman used a price of $7.38 per cubic yard for shoot rock excavation, and $4.01 per cubic yard for pick rock excavation. (R. 434) Black's price has been approved by the Court and agreed to by the parties, Eastman's price which he valued for the appellees, is so far out of line that a comparison by dollars and cents would be of little or

no value. The argument will therefore be presented on a cubic yard basis.

The controversy pertaining to the amount of rock excavation was stated by the Court as follows:

> "There is a difference between the engineers as to the amount of rock excavation in the lines. After the hearing before the Commission, engineers for both sides drilled a hole every quarter of a mile along a main 125 miles long. That extensive investigation developed that the per cent of rock excavation was 20.94 per cent instead of 10.46 per cent used by Black. If over cuts are included, the per-cent is 28. We are inclined to believe that over cuts should be excluded. It is probable that contracts for trenches would be predicated on the trench depth and would not call for over cuts caused by the inability to blast to a neat line. This additional evidence convinces us that Black's estimate of the amount of rock excavation is too low. His estimate on the line used for the test was 24,000 yards; Hamilton's was 72,482 yards. The test showed on Black's own figures exclusive of over cut, 46,790 yards." (R. 307)

From the evidence before the Commission and upon which it made its findings, there was nothing to justify disturbing the Commission's findings as to the amount of rock excavation necessary in trenching for main lines.

Following the hearing before the Commission and pending the trial of the case before the lower Court, the appellees, accompanied by engineers for the Commission, made the resurvey and the drilling test mentioned by the Court. The test was made on a line 125 miles long and weighed by the Court against the estimate of

the engineers on over 3,000 miles of pipe line in the system as a whole.

According to Black's figures developed from the resurvey or drilling test, his estimate for the amount of rock in the 125 mile line was a little less than half what the test showed, while Hamilton's estimate was approximately twice what the test showed. According to the Court's calculation on the resurvey as shown by the quotation from its opinion above, the rock excavation on the 125 mile line was 20.94 per cent. Black having allowed but 10.48 per cent, his estimate as shown by the test was 10.48 per cent too low. On the other hand, Hamilton had used 31.15 per cent for the amount of rock excavation in the 125 mile line. The new survey or drilling test on the Court's calculation having shown that the amount of rock excavation in the line was 20.94 per cent, it necessarily results that Hamilton was 10.11 per cent too high. In other words, Hamilton, in estimating the amount of rock excavation on the 125 mile line, was approximately as much too high as Black was too low, if the resurvey was to be used as a test of the accuracy of their estimates. The Court, in its opinion, stated further:

> "The subject is not capable of exact proof, but we are of the opinion that Mr. Black's amount of excavation should be materially increased. Mr. Hamilton's valuation of rock excavation is $4,211,120. Mr. Black's $1,270,117, of which $1,154,503 is in this account. Applying Black's price to an increase amount indicated by the test results in an increase of this item from $39,432,331 to $40,232,331." (R. 307)

The addition which the Court made to the depreciated value of this account because it found Black's calculation as to the amount of rock excavation to be too low, was $800,000.

The Court and the Commission found the per cent condition of this account to be 90.1 per cent. Reducing the depreciated value which the Court added, ($800,000) to the value new before depreciation for the purpose of finding the exact number of cubic yards which were added by the Court, we arrive at $887,888.

The Court adopted Black's price for rock excavation and as was shown from the quotation from the record previously made herein, this price was agreed to by the Company. Black's price for rock excavation was $2.50 per cubic yard. Dividing the $887,888 added by the Court to the value new before depreciation, by $2.50, the cost of rock excavation, we find that the Court added 355,155 cubic yards of rock excavation to Black's allowance. Black allowed 508,046 cubic yards of rock excavation. (R. 434.), adding to that the 355,155 cubic yards additional found by the Court, gives us a total amount of 863,201 cubic yards of rock excavation which the Court allowed for this account, which covered the excavation for main lines. Hamilton's total allowance of rock excavation for this account was 834,289 cubic yards. (R. 434) Comparing this with the allowance made by the Court because of its addition, we find that the Court allowed 28,912 cubic yards of rock excavation more than that asked for by the Company and estimated by Hamilton.

The test showed that Hamilton was 10.11 per cent too

high, yet the Court gave consideration to the test in adding to Black's estimate because it was too low, and used a figure slightly above that of Hamilton's although the test showed that Hamilton was approximately the same amount too high. The result of course, is impossible and the addition made by the Court, in our opinion, should not stand. The engineers made their estimates on the amount of rock excavation over the whole system. Any attempt to test the accuracy of these estimates by resurvey of but one small part of the line would, of course, produce a ridiculous result.

A further example of the fallacy of applying the percentage of rock excavation calculated on the resurvey or drilling test on a short line to the pipe line system as a whole may be shown by the following comparisons.

In Hamilton's valuation he estimated there were 35,760 cubic yards of shoot rock and 36,722 cubic yards of pick rock in the 125 mile line on which the resurvey or drilling test was made. (R. 434.) The resurvey on the Company's own figures showed 46,619 cubic yards of solid or shoot rock and only 169 cubic yards of pick rock. (R. 441.) If Hamilton's 577,428 cubic yards of pick rock and 256,861 cubic yards of shoot rock over the entire system are corrected in accordance with the percentages of shoot rock and pick rock developed by the resurvey, his 577,428 cubic yards of pick rock becomes 2,557 cubic yards and his 256,861 cubic yards of shoot rock becomes 468,189 cubic yards for the system as a whole, which means exactly nothing, and again shows the

fallacy of applying the result of the resurvey to the whole system.

As further proof of the absurdity of applying a percentage of increase based on the resurvey to Black's figures for rock excavation or a percentage decrease to Hamilton's figures as shown by the resurvey to other parts of the system, we cite the effect of this application on the Pampa-Wichita line, in which case the yardage of rock excavation is approximately the same, Black having 30,909 cubic yards as against Hamilton's 28,046 cubic yards of rock. Applying the same ratios obtained by the resurvey to the foregoing quantities of rock determined on the Pampa-Wichita line, Hamilton's rock quantities became 14,950 cubic yards and Black's quantities became 84,082 cubic yards. Applying the increase to Black's figures or the decrease to Hamilton's figures, obtains a ridiculous result.

There is no way in which the results of the resurvey could be applied to the system as a whole for the purpose of testing the amount of rock excavation without approaching absurdity.

We do not believe it is necessary to give further examples of the effect of attempting to use a percentage of increases or decreases based upon the resurvey. The Court, in attempting to use the result of the resurvey to increase Black's figure, reaches an impossible conclusion and so far as we are able to determine, any application which is made, obtains the same result. On some of the lines Black's estimate for rock excavation was lower than Hamilton's. On other lines Black's was higher

than that of Hamilton. Over the system as a whole, the estimates would level off to a fair average. The Commission so assumed in its findings and we believe that the Commission's findings were amply supported by the evidence. The Court disturbed the Commission's findings because of the resurvey of less than 3 per cent of the line. Having shown that the resurvey could serve no useful purpose in arriving at the amount of rock excavation, it is our opinion that the Commission's findings should stand, and that the Court was in error in adding $800,000 to the Commission's findings.

Assigned Error No. 12.

Engineering and Superintendence During Construction.

Both the engineers for the Company and the engineers for the Commission arrived at the value of engineering and superintendence by taking five percent of the physical properties, except certain items of general equipment consisting of Accounts Nos. 1316, 1380, 1381, 1382, 1383, 1384, 1385, 1387 and 1388, which would require no engineering. The Commission estimated engineering in the manner suggested and found the cost new to be $3,218,585, and the depreciated value to be $2,881,000.

The Commission used the depreciated figure. It is agreed by the parties that since no annual allowance was made for the depreciation of engineering and superintendence, that the account should not be depreciated. The Court, therefore, used the amount found by the Commission for the cost new, which increased the amount going

into the rate base $337,585. The Court added an additional $102,665 because it increased the value of the physical properties to which the percentage was applied. This, we contend is an error. This contention is based upon our argument that the Court was not justified in increasing the value of the physical properties over that found by the Commission. If the values of the physical properties found by the Commission are not increased, the cost new found by the Commission in the amount of $3,218,585 should be the value for Engineering and Superintendence.

Preliminary and Organization Expense.

The Commission found that preliminary and organization expense should be based on three-fourths of one per cent of the value of the physical properties, giving a cost new of $480,008 and the value was not depreciated.

The Court adopted the Commission's finding of three-fourths of one percent of the value of the physical properties, but added $20,617 because it increased the value of the physical properties. If our contention that the Court erroneously increased the value of the physical properties is correct, then the Commission's allowance in the amount of $480,008 is correct.

Administration and Legal Expenditure During Construction.

Both engineers estimated Legal and Administration Expense During Construction on the basis of one-half of one percent of the physical property. The Commission applied this figure to the values found by it and arrived

at a cost new of $340,094, and a depreciated value of $304,084. The Commission used the depreciated value in the rate base. The Court used the Commission's cost new. This was proper, because no annual allowance was allowed for depreciation. The difference between the value new and the depreciated value was $36,010, which the Court added to the Commission's value going into the rate base. The Court also added $10,256 because it increased the value of the physical properties. If our contention is correct that the Court was in error in increasing the value of the physical properties, then the addition of $10,256 is an error, and the Commission's value of the account new should be used.

Miscellaneous Construction Expenditure.

The Court allowed one percent of the physical value including engineering for miscellaneous and construction expenditures, and found the reasonable value to be $680,187 for the cost new and $608,169 as the depreciated value. Because of the agreement of the parties, the Court did not depreciate the account which added $72,018.00 to the Commission's rate base and added $20,513 additional because it increased the value of the physical properties. If our contention as to the value of the physical properties is correct, the Court was in error in adding $20,513 and the Commission's value of the account new should have been adopted by the Court.

Taxes During Construction.

The Court adopted the Commission's findings as to this account, but used the reproduction new value as found by the Commission instead of deducting depreciation. This was proper under the agreement between the parties.

Interest During Construction.

The Court adopted the Commission's allowance of six per cent for interest during construction, but added $468,652 because the Commission depreciated the item, and $120,000 because it increased the value of the properties. If our contention is correct as to the value of the physical properties, the addition of $120,000 was an error and the Commission's value new of $4,351,934 should have been adopted.

Although we have no argument with the Court's allowance of six percent for interest during construction, we do take issue with the Court's reason for allowing six percent instead of eight percent, and because its reason affected its allowance for going concern value, we believe that the matter should be discussed here. In its finding as to interest during construction, the Court said:

> "The Commission used a rate of six percent, the Company eight percent. It is customary to calculate this item at the present prevailing rate charged a person with good credit for temporary advances, which is now six percent. This throws upon the borrower, the owner of the property, the hazard of the borrowed money during the construction period, which must be considered. Two per cent is a reasonable allowance for that hazard, but it is customary

and preferable to make this allowance as a part of going concern value." (R. 308)

It would appear from the Court's opinion that it allowed 8 per cent for interest during construction, but chose to place 6 per cent under the heading, "Interest During Construction," and carried the other 2 per cent to going value. This, we believe was an error.

As stated by the Court, interest during construction is customarily calculated from the prevailing rate charged a person with good credit for temporary advances. The Court found this rate to be 6 per cent.

Under normal conditions, a greater rate of return on the value of the property when subsequently put into public service is allowed than for the use of money borrowed or advanced in construction, because the former involves the contingencies of operation and many other considerations, while the interest to be paid on money borrowed during construction is a fixed amount and is allowed in the rate base with no contingency attached to it. The interest during construction is a fixed allowance, while the earning of a rate after the business is in operation presents some hazard.

The appellee's contention as to the rate of interest to be allowed during construction was definitely set out in their reply brief before the Commission as follows:

> "If eight per cent is a proper rate of return for the investor to receive after the project is placed in operation, on what theory or by what process of reasoning can the conclusion be reached that this same investor is entitled to less return on his money during the period the plant is being constructed?

> You have the same investor and the same money going into the same project. Whatever is fair in one case must be fair in the other."

The Court appears to have adopted the same reasoning but allowed 6 per cent for interest during construction and carried the other 2 per cent over to going value.

The fallacy of this argument is clearly demonstrated by a quotation from the report of the special master in the Denver Tramway case, at pages 22 and 23 of his report:

> "It is common knowledge that a plant like this cannot be constructed in a short time. It follows that the present values contain an account for interest during construction. Under the evidence, it is my judgment that three years is a reasonable construction period in the present case, and that the interest should be computed for half of that time. I find 6 and ½ per cent per annum to be reasonable as the rate to be allowed. There is little relation to be found between a rate of interest to be allowed for the use of money borrowed or advanced in construction, and a rate of return on the value of the property when subsequently put into public service. The later involves the contingencies of operation and many other considerations."

The case is reported as Westinghouse, etc., v. Denver Tramway Co., 3 F. 2d., 235. The report is not included in the decision but it is approved. An examination of the decisions will disclose that interest during construction is never measured by the rate of return allowed. Even if it were, we believe 6 per cent would be reasonable under present conditions.

Going Concern Value.

Mr. Black included in the valuation, Going Concern Value in the amount of $3,820,000. Mr. Hamilton included it at $8,898,532.

The Commission found that both engineers had based their calculations largely upon idle plant following the period of construction, but before the line had reached the maximum capacity. The Commission further found that both witnesses had arrived at their calculations for idle plant upon a hypothetical basis without considering the actual facts in the case, and the actual experience of the Company. After considering the actual facts as to idle plant of the wholesale pipe line company as presented by the evidence in the case, and the actual experience of the Company, the Commission applied the tests which both engineers had laid down as to a proper measure of determining going concern value and found that $2,000,000 was the highest allowance justifiable under the evidence. The evidence from which the Commission reached its conclusion will be discussed later.

The Court appears not to have criticised the Commission's finding of evidence as to idle plant but considers two elements not presented by either of the engineers or the Commission, as follows:

6 per cent interest was allowed during the period of construction instead of 8 per cent, which the Court found to be a reasonable return after the property was put into operation.

The second element considered by the Court was an

annual allowance for depreciation during the construction period.

The Court summarized its reasons for adding the two factors to going concern value in its opinion as follows:

> "The period of construction was two years. Physical deterioration went on during that period when there were no earnings to offset it. The owner's money was embarked in a hazardous enterprise during the construction period; the Commission allowed only 6 per cent for interest during construction on the theory that an owner, with good credit, could borrow money at that rate. But the owner should be compensated for the risk involved in putting his credit back of the enterprise. If 8 per cent is a fair return on moneys embarked in this business, as we elsewhere find, that hazard was present during the construction period. The difference between 6 per cent interest during the construction period and an 8 per cent return in a business venture during construction, is $1,450,645, based on the Commission's valuation. During the construction period, there are no revenues, and depreciation and return (less interest during construction) must be capitalized in going concern value. After construction is completed, and some business is attached, there is an idle investment until the available business is fully attached, even under the most efficient management. ..."

While Mr. Black allowed depreciation and return on idle plant while the Company was acquiring its business, in the amount of $2,784,645, no similar allowance apparently was made during the construction period. The difference between 6 per cent interest allowed and 8 per cent return is $1,450,000. The parties agree on the Commission's figure of 2.96 per cent annual allowance for depreciation. Allowing half of that for the two year construction period, adds approximately $2,175,000. Without undertaking any

precise evaluation of this intangible asset, it is difficult to see how it can be fairly approximated at less than $5,000,000 which is about 6 per cent of the tangible values, a much lower percentage than the percentage customarily allowed." (R. 302, 310)

1.

Considering first the Court's finding that Going Value should be increased because it allowed but 6 per cent for interest during construction and the difference between 6 per cent interest allowed and an 8 per cent return is $1,450,645.

We desire to include here by reference, our discussion presented under the heading, Interest During Construction. For the purpose of brevity and to eliminate repetition, we will not reiterate here the argument there made as to why interest during construction should not be greater than 6 per cent and it should in no wise be measured by the rate of return allowed.

We do not believe that 6 per cent should be allowed for interest during the period of construction and because 8 per cent was not allowed for such item, an additional 2 per cent on the value of the properties should be added to Going Value. There is little relation between the rate of interest to be allowed during the period of construction and the rate of return. Even if it were conceded that the two rates should be the same, it is our contention that under present conditions an 8 per cent return is excessive and that a 6 per cent return would not be unreasonable nor confiscatory.

It should suffice to say that interest during construction

is customarily calculated on the prevailing rate charged a person with good credit, for temporary advances.

Rate of return involves the contingencies of operation and many other considerations, including competition and the possibility of earning the permitted rate over each annual period.

Interest to be paid on borrowed money during the construction period is a fixed amount, and is allowed in the rate base with no contingency attached to it. It is a part of the construction expense and just as definite as the expenditures made for physical properties.

We believe that the Court was in error in adding to Going Value because of the reason stated, and that the approval of the lower Court's theory would tend to increase the already difficult problem of valuing this intangible asset.

The Court speaks of the hazard of borrowed money to the borrower during the construction period and states as follows:

> "Two per cent is a reasonable allowance for that hazard, but it is customary and preferable to make this allowance as a part of Going Concern Value." (R. 308.)

We contend that the hazard of the business is not an element of Going Concern Value and we know of no decisions supporting the Court's statement.

Neither do we believe that the second element considered by the Court as a part of the Going Concern Value presents a sound reason for adding to the amount allowed by the Commission. The Court found that the

parties agreed on the Commission's figure of 2.96 per cent for annual allowance for depreciation and calculated that of such depreciation half for a two years construction period approximated $2,175,000, and considered it in arriving at its allowance for going value. (R. 311)

We believe that the Court was in error in allowing annual depreciation during the construction period. Annual allowance for depreciation is calculated on the service life of the property which begins when the property goes into operation. The construction period is not included in such life. The allowance is so calculated as to return the entire investment during the time the property is in operation. At the time the property goes into operation it is regarded as being in 100 per cent condition for the purpose of calculating the annual allowance and the rate of amortization is based on its estimated service life. This method was used in this valuation.

The result is that the Court's allowance for depreciation of 2.96 per cent during the construction period, is a duplication which again appears in the annual depreciation allowance.

It therefor appears that the Court overlooked this fact and erroneously gave consideration to annual allowance for depreciation during the construction period and added the same to going value on account of such oversight. We submit that any addition made for this element can not stand.

If the Court's theory upon which it added $3,000,000 to the Commission's finding as to Going Concern Value is erroneous, it only remains to be determined whether

or not the Commission's finding as to Going Concern Value was supported by the evidence.

2.

We recognize that it has been more or less the practice to add a certain per cent for Going Concern Value because this intangible item is difficult to ascertain by mathamatical calculation. The difficulty is not present in the case before us. The engineers broke down their elements of Going Value. The elements which they considered are those generally recognized as proper. The evidence showed, however, that they had made their estimates on hypothetical calculations and that a number of elements to which they gave consideration were not present in this case.

Mr. Black testified that he arrived at his value by allowing $15,000 for books and records, $1,020,000 for organization of the operating company, and $2,784,645 for interest and depreciation on idle plant; that is, on that part of the plant or plant capacity that would not be used after the plant was constructed, but before the capacity of the entire plant was used. It is therefore apparent that the largest part of Mr. Black's allowance for Going Concern Value consists of interest and depreciation on idle plant before the pipe line has reached its full capacity. (R. 444)

Mr. Hamilton testified that he had found his allowance for Going Concern Value by computing 10 per cent of the physical property value and calling the result Going Concern Value.

Mr. Hamilton testified that:

"I just took 10 per cent of the physical property value for this particular case for that item.

Q. You have not itemized it?

A. No, I have not itemized it in any way."

Mr. Hamilton testified further: (R. 446)

"Q. As I understand, then you did not arrive at it by finding the cost of attaching this business.

A. It is partially the cost of attaching the business, and the time of the engineers and others in negotiating the contracts, but that, for a wholesale situation, is a small item. The largest cost is the excess capacity that you will have to have for a period of three years, while your distributing companies are getting up to a point where they use the amount of gas that the size of the system is predicated on." (R. 448)

It is therefore apparent that Mr. Hamilton and Mr. Black considered idle plant while the line was reaching the maximum capacity as the largest element of cost to be considered in Going Concern Value.

Both witnesses testified that the Going Concern Value for a pipe line company would be less than the Going Value for a distributing plant. Mr. Hamilton testified to the difference between Going Value for a distributing plant and a pipe line company as follows:

"Q. Do you mean to say, Mr. Hamilton, that every plant of the same value should have the same allowance for going value?

A. No, because there would be a very different allowance between your pipe line plant or your distribution plant or an electric plant or something like that. There might be a wholly different basis.

Q. For instance you take the distribution plant, take the one here in Topeka, for example—
A. Yes, sir.

Q. If you assumed that you would reproduce it now, and it had no customers, it would mean you would have to attach in that case, thousands of customers before the business was established?
A. That is true, and 10 per cent allowance in that distribution plant would not be sufficient, in my judgment.

Q. Then take a pipe line company like this, and the number of customers you have is not very large, very many involved, don't exceed three or four hundred?
A. That is true.

Q. That should be taken into consideration in arriving at the Going Value in this case?
A. That is true." (R. 452-3)

It was therefore apparent and the Commission properly considered the main element of the cost of Going Value of this pipe line system, whose business is wholesaling gas, to be interest and depreciation on idle plant during the period the Company is acquiring its business and reaching its maximum capacity. The evidence in this case clearly disclosed that on the major part of the pipe line system there was very little idle plant following the construction period. The testimony on this matter is set out on pages 454 to 462 of the record as follows:

"Jarboe, superintendent of all pipe lines of the system, testified that the line to the Amarillo field was construeted for the purpose of taking care of

the present demand of the pipe line system. (R. 454)

Hamilton testified:

'Q. The line from Amarillo to Wichita, that as I understand, when it was built, was built for the purpose of taking care of the demand for gas you had at that time?

A. Yes, sir.' (R. 454)

"Mr. Eastman testified as to the Amarillo line from Texas to Wichita and Ottawa:

'Q. Now this line was built to Texas; was any addition to the market procured from that line, were any additional markets procured, any new customers? Are there any connected to that line between Texas and Wichita?

A. No new cities; there may be a few small towns along that line served, but they are inconsequential.'

'Q. Was there any other purpose than to supply existing markets?

A. No.' (R. 461)

"Eastman testified that the line from Ottawa to Kansas City was finished in 1929.

"In January, 1930, from the 16th to the 19th, the pipe line's capacity was exceeded and it was necessary to shut off the industrial gas in order to supply the demand for domestic gas. (R. 461)

"Hamilton testified the third line was built from Ottawa to Kansas City to take care of increased capacity there.

"Jarboe testified further that the lines to the Amarillo, Oklahoma City and Seminole fields are purely extensions to procure additional supply. No new customers were added: just went to take care of the market.

"At the time of the purchase of the Kansas Natural, the personnel was retained and continued. There was a demand for the gas line from Wichita to Texas, the Amarillo line. The same is true with reference to all the additions put on to the old system.

'Q. As I understand it each one of them was built because there was a need and it was necessary to complete this, to furnish gas to the main pipe line, or to places where it had already contracted or made arrangements to sell gas?

'A. One or the other.

'Q. That is correct?

'A. Yes.

'Q. Each one of those red lines denoting the construction of new pipe lines was built by the Cities Service in order to fill a need that existed at that time?

'A. Yes.

'Q. Upon their being completed they were then immediately put in use?

'A. Yes.

'Q. And have been in use and operation since then?

A. Yes.'" (R. 462)

It was therefore apparent, and the Commission so concluded, that both witnesses had arrived at their calculations for idle plant upon a hypothetical basis without considering the actual facts in the case and the actual experiences of the Company. *After considering the actual facts as to idle plant of this wholesale pipe line Company as testified to in this case and the actual experience of the Company, the Commission applied the tests which both engineers laid down as a proper meas-*

ure of determining going concern value and found that $2,000,000 was a proper allowance.

We believe that under this evidence $2,000,000 was the highest allowance which could, under any circumstances, properly be made for Going Concern Value. This allowance included an allowance for books and records, organization of the operating Company and a reasonable allowance for interest on idle plant. The Commission also considered the very apparent fact that a large number of the elements of Going Value were considered and included in other items of value by the engineers. (R. 137) This is made apparent by a reference to the overhead and intangible values calculated by the engineers and allowed by the Commission.

In considering the allowance for Going Value, we must take into consideration the general nature of the pipe line company's business as disclosed by the general testimony of the witnesses. In arriving at the reasonableness of the rate charged the pipe line company, we are considering the reproduction of the pipe line and not the distributing plants. The distributing plants were present and available before the pipe line was constructed. It was not necessary to construct the pipe line and then obtain a market. The market was present. The pipe line was constructed to supply an already existing market. (R. 461-2)

The distributing plants had been constructed for the distribution of artificial gas and natural gas which was produced from local fields. The local fields were being

exhausted. Artificial gas was not as practicable as natural gas. When the supply of natural gas was discovered, it remained only to construct the line from the supply to the already existing market. If the pipe line system were to go out of use and a new one be produced, the consumer and the distributing plants would be present and available.

The cost of attaching distributing companies to a pipe line system does not compare with the cost of acquiring and attaching customers to a distributing system. The burden of acquiring new customers is placed upon the distributing plants and not upon the pipe line company. The record discloses that the pipe line company serves but 120 some odd towns or distributing plants in the State of Kansas. The cost of attaching this already existing market would be negligible. (R. 448)

The regulation of extensive pipe line systems by a State Commission, is new. The extensive construction of inter-state pipe lines is of more or less recent origin. Rules for measuring Going Value of pipe line systems have not been laid down by the Courts. The Public Utilities Commission of Ohio recently had before it the question of the Going Value of a pipe line transmission system engaged in wholesaling gas in the case of the appeal of the Columbus Gas and Fuel Co., No. 5935. In the opinion, the Commission said:

> "It is quite manifest that the many reasons given by the experts as to why a going-concern value should be added to the physical value of the property within the city of Columbus does not obtain *as to the pro-*

duction and transmission system, as each of these was built for the definite purpose of supplying customers already secured and we feel that there is no justification for adding going-concern value to the production and transmission system. As we have before had occasion to state, if there was any definite cost to the company in doing those things which are so ingeniously developed as being the possible element of cost in the reproduction of the property, we would be inclined to allow them as a proper element of value, but we are not impressed with the fact that a going concern value amounting in the aggregate to millions of dollars can be built up on a theory that expenses are to be incurred after the property has been reproduced which were not, as a matter of fact, incurred in the original construction of the property. We cannot conceive that there would be any expense of attaching business to a producing pipe line company which has been built for the sole purpose of supplying already existing customers, nor are we impressed with the cost incident to training personnel, as the business of producing, transporting and distributing gas has been so long in operation that an abundant supply of well-trained personnel is always at the command of the company, and in these times there is probably a considerable oversupply." (P. U. R. 1933a P. 337.)

We therefore respectfully submit that the allowance of $2,000,000 made by the Commission was ample under the circumstances of this case.

Assigned Error No. 13.

GAS LEASES.

Summary of Argument.

All Leases, (1,262,361 acres).

COMPANY'S VALUATION (Fair Value)	$12,914,189.00
COMMISSION'S VALUATION (Fair Value)	6,279,237.00
COURT'S VALUATION (Book Value) (Finding 14)	5,727,272.00

Used and Useful, (71,267 acres)

COMPANY'S VALUATION	$ 5,124,940.00
COMMISSION'S VALUATION	2,874,390.00
DIFFERENCE between allowance by COURT for (ALL LEASES) and allowance by COMMISSION for 71,267 acres (USED AND USEFUL)	2,852,882.00

This account covers the value to be allowed for gas leases going into the rate base. The evidence pertaining to this account will be found on pages 462 to 508 of the record.

The account is not only important because of the addition which it makes to the valuation, but it also materially effects the operating income. The Company has asked for an annual allowance for reserve requirements pertaining to gas leases as follows:

> General Development Expense, including lease rentals, cost of acquiring leases and geological expense in the amount of $532,530.
>
> Amoratization of Non-Producing Leases, which is to provide a reserve to amoratize the cost of leases which are not producing, in the amount of $314,981.
>
> Dry Hole Expense, which is an annual allowance

to create a reserve to protect the Company against dry holes in prospecting its prospective acreage, in the amount of $174,747.

Depletion of Producing Leases in the amount of $70,509.

These annual allowances which the Company asks for its gas leases pertain to several hundred thousand prospective acres, a great part of which is not accessible to the system and is not even known to be capable of producing gas, and other proven leases including the Hugoton field, which is so far from the present pipe line that practically a complete new system would have to be constructed to make the acreage available to the present consumer. The Company asks to have the consumers pay in over a million dollars a year for the purpose of carrying its leases.

Two questions are presented pertaining to the value of this account.

(1). Was the Commission justified in excluding from the rate base, certain gas leases owned by the Company, on the ground that they were not "used and useful" and not likely to be within the near future?

(2). The valuation of the leases.

The Commission valued all of the gas acreage owned by the Company at $6,279,237, but included in the rate base as used and useful only 71,267 acres which it found from the reserves as testified to by the Company's engineers to be sufficient to supply the gas requirements of the Company for all of its produced gas for twenty-

two years. The Commission valued the 71,267 acres included by it in the rate base at $2,874,390.

The Company contended that the value of all of its gas leases is $12,914,189, and that the value of that part of its leases included in the rate base by the Commission is $5,124,940.

The lower Court included in the rate base, all of the Company's gas acreage, embracing developed, proven, probable and prospective acreage, and valued the same at $5,727,272, which was the book value. The lower Court disapproved the Commission's finding that only 71,267 acres of gas leases were used and useful in the system, and included all of the gas acreage. It stated its reasons in part, as follows:

> "Who shall determine what reserves are adequate? A Commission with no monies invested, or the owners of this pipe line which without gas is worse than useless? Within the limits of reason, undoubtedly that determination must be left with the owner."

The Court stated further:

> "The Commission's findings are predicated on a 20 per cent recovery; within two weeks of its order, the Texas R. R. Commission cut this to 4 per cent. What the future may hold by way of state action, no one knows."

As to the latter suggestion of the Court, it might be stated that the reason for the order of the Texas Commission was the fact that there was an over supply of gas in the field for which the independent operators could not find a market. A complete answer to the Court's suggestion however, is the fact that the Court has since

held the Texas order limiting the "take" to be invalid.

It is the contention of the Commission that the amount of reserves which a company should carry is best determined by its requirements.

A gas company should not be allowed to speculate in gas leases and have its speculations protected by charges to its consumers. Neither should it be allowed to place in its valuation for the purpose of increasing its return, gas reserves of an amount over and above those necessary properly to serve its customers.

The record in this case is quite complete as to the requirements of the pipe line company and there should be no difficulty in determining a reasonable allowance.

It is common knowledge that gas companies acquire leases for other purposes than those of simply supplying their consumers. One very common reason for acquiring leases is for speculation as to increase in value. When a company with a large acreage is able to acquire a monopoly by purchasing a large part of the available gas supply, the value of the acreage is necessarily increased and a profit to the company is the result. This is demonstrated in the present case by a sale to the Texoma Co., by the pipe line company now under consideration, in August, 1931, of 60,000 acres of leases. These leases cost the Company less than $15.00 per acre. Some of them it sold for $19.00 per acre and some at $45.00, netting the Company a profit of $1,110,157.61. The Company was protected against loss in this adventure by its annual requirements set up against its present consumers, but when the profit was made, the consumers received

no benefit by way of a credit to the operating income of the Company.

The lower Court gave little weight to this incident because it found that the gas leases which were sold were purchased by the pipe line company for sale to an affiliated company. This we believe to be contrary to the evidence. The record shows that a large part of this acreage was acquired by the pipe line company before the sale of the Texoma Co. was anticipated.

It is also true that gas acreage is acquired by gas pipe line companies over and above their actual reserve requirements, for the purpose of preventing competition. If they are able to obtain control of newly discovered gas acreage, in the territory which they are serving, they are of course able to prevent another company from coming in and making use of such gas for the purpose of competing with the existing system. This no doubt, is good business judgment on the part of the Company, but certainly the consumers should not be required to carry such burden. This is particularly true where the acquisition of the additional acreage has tended to cut off competition which might have supplied the consumers in the particular localities with their own local gas. Naturally, there can be no direct testimony that this was done. We believe, however, that the evidence submitted, when considered as a whole, raises a clear presumption from which such a finding can be made.

In this summary, we will not refer to the record in

setting out figures because such reference is made in the detailed discussion which follows:

The Company owns gas acreage which it classifies as follows:

Developed,	42,297 acres
Proven	196,170 acres
Probable	25,607 acres
Prospective	998,287 acres
Total	1,262,361

Of the proven acreage listed above, 123,440 acres is in the Hugoton field, located in Kansas and Oklahoma, all of which is 90 miles from the Company's present pipe line system and is therefore not available to the present system without a material addition to its system. The 998,287 prospective acres are not only distant from the pipe line but are not known to be capable of producing gas.

As to the material part of this acreage, there is no means by which the present market value can be ascertained. There are no purchasers for this large acreage because all the present companies have an over supply. Most of the acreage is already monopolized by large companies and if a purchase became necessary, the price could, to a great extent, be fixed by the present pipe line system. The evidence shows that the Burnett lease containing 63,880 acres which the Company owns in the Amarillo field, and is the largest producing field in the world today, cost the Company nothing except that it was to pay a minimum royalty on the gas pro-

duced of $50,000 per year. 21,158 additional acres in the proven Amarillo field cost $12.78 per acre which the Company now values at $93.00 per acre. The evidence further shows that there are 125 shut in wells in the Texas field owned by independent operators who are unable to sell their gas. This tends to show that there is very little practical value attached to a gas lease in the field unless it is in the hands of one of the few companies having a monopoly on the pipe line transportation.

The Company's sales reached the highest peak during the year 1930. During that year its daily average sales were 203,189 M. C. F. The requirements for the year were 74,163,945 M. C. F. During the year 1932 the Company's yearly requirements were 54,262,574 M. C. F., with a daily average of 149,548 M. C. F.

The evidence further showed that from its purchase contracts and producing wells, the Company had a potential open flow of 3,929,632 M. C. F., and that twenty per cent of this potential could be taken daily giving a daily supply of 785,926 M. C. F., which is more than 3½ times the average daily requirement.

The recoverable gas which could be taken from the Company's own gas leases (its gas reserve) and not including gas from its purchase contracts based on its engineer's estimate, is as follows:

Leases in Kansas, Oklahoma and Missouri, exclusive of the Hugoton field, 33,424,000 M. C. F., Hugoton field 688,590,000 M. C. F.; Amarillo field, 1,726,650,000 M.

C. F., totaling 2,448,664,000. This is available from the developed, proven and probable acreage in the amount of 233,582 acres and excludes the 998,287 prospective acres which is not taken into account in determining the reserve because it is not known that gas will be discovered and because they are better prospects for oil than gas, which is another reason for the Commission's belief that they should not be included in the rate base.

Based on the Company's experience for the year 1930, the year of its highest requirements, this gas reserve is sufficient to last the Company seventy-one years, for its requirements for produced gas. The Amarillo field alone, on the same basis, is sufficient for fifty years. It was on this evidence pertaining to the Company's requirements and its reserves that the Commission found but 71,267 acres to be used and useful in serving the present consumer.

The Commission found the following to be used and useful:

All developed acreage which included 22,090 acres in the Amarillo field; 20,207 acres in Kansas, Oklahoma and Missouri; all of the probable leases, except the Hugoton field, in Kansas, and Oklahoma in the amount of 1,060 acres; and undeveloped acreage in the Amarillo field in the amount of 27,910 acres. The Commission excluded the Hugoton field as not used and useful in the present system because it was undeveloped and too far removed from the pipe line.

Based upon the estimates of the Company's engineers

the recoverable gas (gas reserve) from the acreage allowed is 783,424,000 M. C. F., which, considered in connection with the Company's past experience, is sufficient to furnish the requirements for produced gas for over twenty-two years.

It was the opinion of the Commission that the testimoney of the officers of the Company as to the amount of reserve which the Company should carry, could not stand in the face of the actual facts as to its reserves and its requirements, and that there was no justification for including in the rate base, 998,287 acres of prospective leases which were not connected with the present pipe line system and may never be capable of producing gas, and the 123,440 acres in the Hugoton field which is undeveloped and is 90 miles from the pipe line. When this acreage is made available by development and reconstruction of the pipe line system, the additional investment made necessary and the additional earnings resulting from new customers reached can be given consideration. Those questions will present a pipe line system entirely foreign to the one we now have before us and will be met when they arise in the future. They can be given no consideration as to the valuation of the property that is used and useful in the present system.

A detailed discussion pertaining to the questions of the valuation of the gas leases follows.

GENERAL DESCRIPTION OF GAS LEASES.

The Company owned as of September 1, 1931, gas leases covering 1,262,361 acres of land situated in Kansas, Oklahoma, Missouri and Texas.

These leases grant to the lessee the right to drill for and take oil and gas and generally (with some exceptions) run for a period of ten years from date, after which, if oil or gas is not then being produced they expire, otherwise, they run so long as oil or gas is produced. The leases, in general, require the payment of rentals until development and require the lessee, after development, to pay to lessors a royalty of one-eighth of the oil and gas. The Company owns only the gas rights in these leases, the oil rights being held in most cases by affiliated companies.

These leases have been classified into developed, proven, probable and prospective.

"Developed" leases are those on which gas is actually being produced.

"Proven" are those adjacent to production, which will be drilled and on which it is considered gas will be found.

"Probable" consists of acreage adjacent to proven acreage having favorable geological structure, but which has not been completely tested.

"Prospective" consists of all other acreage. (R. 463)

The acreage owned by the Company, and its classification of its acreage is as follows:

COMPANY'S CLASSIFICATION.

	Developed	Proven	Probable	Prospective	Total A.
Texas	22,090	72,780	24,547		119,367
Hugoton (Kan. & Okla.)		123,440			123,440
Okla., Kan. & Mo.	20,207		1,060		21,267
Okla., Kan. & Texas				998,287	998,287
Totals	42,297	196,170	25,607	998,287	1,262,361

(Ex. 40) (R 463, 479, 489)

The Company does not produce from its own leases all of the gas it sells. Ever since its organization it has purchased the major portion of its gas. In 1930, the year of its greatest gas sales, it purchased about 54 per cent and produced 46 per cent. (R. 485)

In addition to the gas leases owned by the Company, it owns many gas purchase contracts which entitle it to the gas produced from leases in Kansas, Oklahoma and Missouri, covering 782,421 acres of land with 1,502 gas wells. (R. 485)

The gas wells situated on the lands covered by these purchase contracts, the gas from which the Company is entitled by paying the agreed price per M. C. F., have an open flow of gas of 2,138,170 M. C. F. per day. (R. 485)

Of the gas leases owned by the Company, only 42,297 acres have been drilled or developed, with 244 wells on the Kansas-Oklahoma developed acreage, and 60 wells on the Texas-Amarillo developed acreage. The Company thus owns but 304 wells. The remaining 1,220,064 acres of gas leases owned by the Company have not been drilled and are undeveloped. Nearly one million of these leases are prospective. 98 per cent of all of

the gas contained in the Company's gas leases (not including the purchase contracts) is in the Amarillo and Hugoton fields, and the remaining 2 per cent is in the Kansas and Oklahoma fields. (R. 489)

THE FAIR VALUE OF THE GAS LEASES.

We contend that in fact the leases owned by the Company have no market value and that it is no more possible to arrive at a market value of 1,262,361 acres of gas leases than it is to arrive at the market value of the entire plant of the Company. No purchaser could be found for this quantity of gas leases and they are valueless except in connection with a major pipe line system.

The value of these gas leases found by the Commission is in excess of their cost of acquisition and book value, and we submit should be sustained. The facts from which this valuation was found and the valuation found by the Commission and that claimed by the Company for the different classes of leases are as follows:

VALUE OF LEASES—AMARILLO FIELD.

(The valuations hereafter referred to are exclusive of all wells and equipment and cover the gas rights only.)

94,820 acres of the Company's proven gas leases are situated in what is known as the Amarillo (Texas)

PROVEN SWEET GAS AREA.

This "proven sweet gas area" is a portion of a huge field in the Panhandle and is approximaely 130 miles long and from 7 to 40 miles wide. It contains approxi-

mately 1,001,785 acres under all of which it is conceded that gas is present in large quantities.

Of the Company's acreage in this proven field 22,090 acres are developed, having 60 gas wells thereon. (R. 463, 489)

One of these leases is the Burnett lease. It covers 65,880 acres and requires a minimum payment of $50,000 per year in advance, for ten years, whether or not gas is taken from the lease. For the first two years, the royalty is one-eighth of 3½ cents per M; for the next five years, one-eighth of 4 cents per M; thereafter, one-eighth of 4 cents unless the price of gas at the well is increased, in which event the royalty is to be one-eighth of the weighted average price. The Burnett lease is not a solid block, there being within the block covered by said lease other gas leases owned by others than the Company, on which there are producing wells. Up to the present time the $50,000 annual payments required on this lease have exceeded the royalty earned on the gas taken. (R. 479)

Eight witnesses testified for the Company on the market value of its leases in the Amarillo field, five connected with gas companies, whose natural desire is to see that high valuations are placed on gas leases, and two employees.

Witnesses for Company place the market value of these leases at from $45.00 to $125.00 per acre, for the acreage situated within the "proven sweet gas area", with the higher value on the blocked acreage, and at from $5.00 to $25.00 for the probable. (R. 480, 481)

F. G. Holl, for the Commission, placed the value of the leases in the "proven sweet gas area" for 60,940 acres, blocked, at $45.00 per acre, for 33,767 acres, not blocked, at $25.00 per acre, and for the probable $1.00 per acre. (R. 481)

Holl's testimony showed that scattered acreage in Wheeler County, part of the proven sweet Amarillo field, where the largest wells in the entire field have been found, could be purchased at $5.00 per acre for both oil and gas; that in Potter County, near where the largest wells have been brought in, in September, 1931, a lease which was about to expire consisting of 5,000 acres, was renewed at $8.00 per acre. (R. 480)

The Company's evidence showed that in August, 1931, it conveyed to the Taxoma approximately 60,000 acres of leases with nine producing wells, comparable with the acreage retained in the proven sweet area, some at $19.00 and some at $45.00 per acre, which cost the Company less than $15.00 per acre, and that on this sale the Company made a profit of $1.110,157.61, not including a bonus of $121,000 paid from the proceeds of said sale to the Empire Gas & Fuel Company, an affiliated Company. (R. 480)

In addition, the Company at the same time sold to the Texoma nine gas wells at $216,000, which cost the Company only $205,000 at a profit of $11,000. The evidence shows that some of the leases which were transferred to the Texoma, August, 1931, were procured by the Company as early as 1928, and as the agreement to transfer leases to the Texoma was not made until 1930

it cannot be, as claimed by the Company, that these leases were all purchased for the Texoma, because many of them were acquired by the Company long before any deal with the Texoma was effected. (R. 492)

The books of the Company show that from January 1, 1930, to June 30, 1931, it purchased 21,158 acres in the proven sweet Amarillo field, now valued by it at $93.00 per acre, at an average cost of $12.78 per acre. (R. 480)

The evidence shows a large oversupply of gas developed by gas companies in the Amarillo field which cannot be sold for lack of market.

Gas was being sold in this field at 2 cents per M.C.F. at the well in September, 1931. (R. 481)

That in September, 1931, there were 125 "shut-in wells" with an open flow of 2,260,000,000 c.f. per day, with no outlet or market. (R. 481)

That the Lone Star Gas Company Pipe Line was connected to 65 wells in this field, and for the first six months of 1931, it took from these wells only 100 M.C.F. per day, at the rate of $2.00 per day (less than interest on cost of well), and that operators were not drilling on account of an over supply. (R. 481)

Practically all of the lands in the Amarillo proven sweet field have been leased by the eleven major pipe-line companies, which have pipe lines into this field, and by certain independent operators who own the "shut-in" wells. These gas companies have the monopoly of these leases and there is no market for gas in this field except as made by regulated demand for gas. Due to this fact

it cannot be said that gas leases in this field have any market value, fair or otherwise. (R. 481)

PROBABLE ACREAGE—AMARILLO FIELD.

The Company owns 24,547 acres of gas leases in Texas situated outside of the "proven sweet gas area" classed by it as "probable," some of which are in the sour gas area, and therefore not adapted for gas for domestic use. (R. 481, 492)

The testimony of the witnesses for the Company as to the value of this acreage varied. Some stated that part of these are worthless, others at from $5.00 to $25.00 per acre. (R. 481)

F. G. Holl, for the Commission, placed the fair value of the gas rights in that part of this acreage, which he classed as "favorable," at $1.00 per acre, and 50 cents per acre for that part which he classes as "prospective," and nothing for the remainder of the Texas acreage. (Ex. 46) (R. 481)

The Commission valued this probable acreage at not more than $2.00 per acre, and found that the value of these 24,547 acres of probable leases was not more than $49,094 and we submit that this is a fair valuation.

The Company values its acreage in the Amarillo field at—

94,920 acres proven	@	$93.64	$8,879,628
24,547 acres probable	@	$17.20	422,367
Total			$9,301,995

The Commission found the value of the gas leases in the Amarillo field to be not in excess of:

Proven 60,940 acres, blocked	@ $50.00	$3,047,000	
Proven 33,880 acres, not blocked	@ 35.00	1,185,800	
Probable 24,547 acres	@ 2.00	49,094	
Total			$4,281,894
Difference			$5,020,101

(R. 464, 478)

We submit that said acreage has in fact no market value, because in August, 1931, the Company sold approximately 60,000 acres of gas leases from this field comparable with those retained in this field, some at $19.00 and some at $45.00 per acre, which had cost the Company but $15.00 per acre, and because from January 1, 1930, to June 30, 1931, the Company purchased 21,158 acres of these leases at an average cost of $12.78 per acre, that the valuation placed on these leases by the Commisssion is fair and indeed liberal.

VALUE HUGOTON LEASES.

(Kansas and Oklahoma.)

The Company owns 123,440 acres of gas leases in the Hugoton field situated in Northwestern Oklahoma and southwestern Kansas, all of which it contends are "proven." (Ex. 40)

This is another enormous gas field estimated to comprise 1,000,000 acres of gas-productive lands. Its limits

are not yet defined. They can be determined only by additional drilling. Dr. Raymond C. Moore, state geologist, estimates the gas reserves in this field as sufficient to supply all of the State of Kansas, on the basis of the amount of gas now used in Kansas, for a period of over 100 years. There is a market for but a small portion of the developed gas in this field. Little drilling has been done, but there is sufficient drilling to demonstrate that this is a rich field of gigantic proportions. (R. 482)

Of the Company's acreage, F. G. Holl, for the Commission, classified 84,367 acres as "proven," 32,008 acres as "probable," and the remainder as "prospective." (R. 463)

There is no development and no wells on any of the Companys acreage in the Hugoton field. The Company's leases consist of one large lease, the Stonebreaker lease, covering 25,280 acres, and over 500 smaller leases. The terms of each of these 500 leases require the drilling of a well within ten years from its date; otherwise the lease expires at the end of ten years. The cost of a well in this field is over $20,000.00 and if the company is to hold these leases it will have to drill at least 500 wells within seven years from this date, that is, before 1940, at a cost of over $10,000,000.00 or said leases undrilled will expire. The Company has no pipe line within ninety miles of these leases. (R. 482)

Witnesses for Company, four in number, testified that the fair market value of the gas rights in these leases, which are in the proven area, is from $3.00 to $10.00 per acre, and the Company claim that the fair market value

of its 123,440 acres of leases is $1,172,680.00. (R. 482)

Against this is the testimony of F. G. Holl that at the time of the hearing, leases conveying both the oil and gas rights could be purchased in the proven area of this field at $1.00 to $2.00 per acre; that the Derby Oil Company had within sixty to seventy days prior to his testimony purchased both the oil and gas rights on 5,947 acres of leases, all in this proven area, at $1.00 and $2.00 per acre. (R. 482, 483)

Holl valued the gas rights in these leases at $7.50 per acre for the proven blocked, $1.50 for the proven unblocked, $1.00 for the probable, and 50c for the prospective, total $313,771.00. (R. 483)

The Company values this acreage at $1,172,680 or $9.50 per acre.

The Commission valued it at $556,116.00, at $7.50 for the blocked proven area; $5.00 for the unblocked proven, $2.00 for the probable area. The difference is $616,564.00. (R. 483)

The cost of these leases to the Company was from $1.50 to $6.00 per acre.

As the undisputed evidence shows that at the time of the hearing the Derby Oil Company purchased 5,947 acres in the proven area at $1.00 per acre, we submit that the valuation found by the Commission is liberal.

VALUATION KANSAS-OKLAHOMA LEASES.

(Exclusive of Hugoton.)

The following is a classification, acreage and valuation by the Company of its leases in Kansas and Oklahoma, where the Company owns 21,267 acres of gas leases: (Tr. 717-719)

Proven and Developed:				
Kansas	16,125		$138,240	
Oklahoma	4,082		239,700	
Totals		20,207		$ 377,940
Probable Acreage:				
Kansas	80		8,000	
Oklahoma	980		57,000	
Totals		1,060		65,000
Totals		21,267		442,940

(Tr. 935)
(R. 483)

This classification and valuation was accepted by the Commission and is not in dispute.

VALUE OF PROSPECTIVE ACREAGE.

The amount of the prospective acreage is 998,287 acres. It is scattered throughout Texas, Oklahoma, Kansas and Missouri. From its location its value, if any, is for oil and not for gas.

The leases were taken in most instances by affiliated companies for oil and gas, and the gas rights then assigned to the Company. An inspection of the map attached to the Company's exhibit 3, Davis report, wherein the amount of acreage held by the Company is written on each county, will show that the most of this prospec-

tive acreage is not accessible to the pipe lines of the Company.

These leases are not considered in arriving at the gas reserve of the Company on account of their speculative character.

This prospective acreage is what is commonly designated as "wild-cat" leases.

From July 1, 1931, to November 1, 1931, the Company surrendered 61,471 acres as not of sufficient value to warrant payment of rentals. (R. 493)

Mr. Nesbit, the Company's chief geologist, valued this prospective acreage at $2.00 per acre. (R. —)

Ralph E. Davis, geologist and gas engineer, the Company's witness, classified 1,031,127 acres of the Company's acreage as "prospective" and placed its value at $1.00 per acre. (R. 492)

Holl, for the Commission, classified 268,909 acres as favorable at $1.00 per acre, 616,073 acres as prospective at fifty cents, and the remainder as of no value for gas. (R. 493)

The company values these leases at $2.00 per acre, the Commission found that the value of this prospective acreage to be not in excess of $1.00 per acre. Company's value, $1,996,574; Commission, $998,287; difference $998,287. (R. 464, 478)

SUMMARY.

The value of all of these leases, as claimed by the Company, is $12,914,189.00 as follows:

Company's Classification and Valuation of Acreage.

Name of Field	Acres Proven	Acres Probable	Acres Prospective	Total Value	Value Per Acre
Amarillo	94,820			$8,870,628	93.54
do		24,547		422,367	17.20
Hugoton	123,440			1,172,680	9.50
Kansas & Okla. (All other)	20,207			377,940	18.70
do		1,060		65,000	61.32
do			998,287	1,996,574	2.00
Totals	238,467	25,607	998,287	12,914,189	
Grand Total		1,262,361 acres. (R. 464)			

The valuation of all of the Company's leases as found by the Commission is not more than $6,279,237.00 as follows:

Commission's Classification and Valuation of Acreage

	Acres		Value per Acre	Fair Market Value
AMARILLO FIELD (Texas)*				
Developed and Proven				
Blocked	60,940	@	$50.00	$3,047,000.00
Not blocked	33,980	@	35.00	1,189,300.00
Total	94,920*			$4,236,300.00
Probable Acreage	24,547	@	2.00	49,094.00
Total	119,367			$4,285,394.00

*Of the above 22,690 acres are developed with sixty producing wells

HUGOTON FIELD (Kansas and Oklahoma)				
Blocked	25,280	@	7.50	189,600.00
Not blocked	59,087	@	5.00	295,435.00
Probable	32,008	@	2.00	64,016.00
Total	116,375			
Prospective	7,065	@	1.00	7,065.00
Total	123,440			$556,116.00

	Acres	Value
Proven: Kansas, Oklahoma and Missouri	20,207*	$377,940.00
Probable: Kansas, Oklahoma and Missouri	1,069	35,000.00
		$412,940.00
Prospective	968,287@$1	968,287.00
Grand Total	1,262,261	$6,279,227.00

*These are developed with 244 wells.

The difference is $6,634,952.00

(R. 478)

GAS REQUIREMENTS.

The Company's gas requirement for all of its consumers, domestic and industrial, for the year of 1930, that being the year of its highest sales, was 74,163,945 M c. f., or an average of 203,189 M c. f. per day. This is calculated on an 8-Oz base. As the gas which it produces and purchases is on a 2-lb. base, the above amount should be reduced 9.2 per cent. However, in the calculations appearing hereafter the reduction is not made in order to compensate for the gas used in the Company's stations and for leakage which the company states is 5 per cent, so that this 9.2 per cent is more than sufficient to absorb this loss. (R. 485)

In the year ending June 30, 1932, and on the same 2-oz. base, the company's requirements for all its consumers was 54,621,574 M c. f., or a daily average of 149,648 M c. f. (R. 484)

For the year of 1930, the Company produced from its own wells 34,401,978 M c. f. and purchased 39,761,967 M c. f. In other words, it produced 46 per cent and purchased 54 per cent of its gas requirements. The amount of gas produced by the Company in the year, 1930, is the largest amount the Company has ever produced from its own wells, either before or since that time. The remainder of the gas sold is purchased from others. (R. 491)

In addition to the gas leases owned by the Company, it owns through purchase contracts the right to the gas produced upon 782,421 acres in Kansas and Oklahoma,

adjacent to and connected to its pipe lines, on which there are 1,502 wells.

The open flow of gas from these purchase contract wells (potential) is 2,138,170 M c. f. (R. 485)

The gas from these purchase contracts, together with gas from the Kansas and Oklahoma wells is sufficient to furnish the entire requirements of the Company with the Amarillo field and pipe line cut off, and in fact has done so when the Amarillo line has been shut down. (R. 494)

It is proper to take from a gas well at least 20 per cent of its open flow; Nesbit, 20 per cent; Davis, 20-30 per cent; Hardy 25 per cent. (R. 485)

At the time of the peak demand, January 16, 1930, the purchase contract wells actually put into the pipe line 12 per cent of their open flow. The reason why a greater proportion was not taken was due to lack of capacity of the pipe line to carry the gas. (R. 493)

The open flow per day (potential) of the wells owned by the Company, as of July 1, 1931, was 60 wells, Amarillo, 1,532,625 M. c. f. Kansas, Oklahoma and Missouri 244 wells, 258,837 M c. f. so that the total open flow (potential) of all the wells controlled by the Company was:

	M c. f.
Purchase contract	2,138,170
Amarillo—(60 wells)	1,532,625
Kansas, Oklahoma & Missouri (244) wells	258,837
Total open flow (potential)	3,929,632

(R. 485)

The highest demand, on the coldest day (peak load), occurred on January 16, 1930. At that time the Company used 330,000 M. c. f. which was the full capacity of the company's pipe line system. The maximum capacity of the Amarillo pipe line, a 20 inch line, is 125,000 M. C. F. per day. (R. 485, 500)

On the basis that 20 per cent of the open flow of the produced and purchased gas is available for use, the company had daily available 20 per cent of 3,929,632 M. c. f. or 785,926 M. c. f., which is more than three and one-half times its daily average requirement, for the year when it sold the largest amount of gas and five times its daily requirements for the year ending June 30, 1932, and is two and one-fourth times the peak load and maximum capacity of its pipe-line system.

It is claimed that the company cannot put into its pipe lines 20 per cent of the open flow in the winter months, when the line pressure is high. If this be true, it does not prove the gas is not there or available. It only shows that the Company's pipe line and compressor capacity is insufficient. (R. 493)

Mr. Stuntz, for the Company, testified:

"Q. Now what percent of open-flow gas can you get out of the Oklahoma City wells?

A. About 10 per cent of the dry gas in Oklahoma City would be about all the line would carry.

Q. You mean on account of the size of the line?

A. Yes."

* * * * *

"Q. Let me see if I understand you, then. Is it true that the capacity of your pipe line at Oklahoma

City is such, or has been less than the capacity to obtain gas in purchase contracts?

A. That is right.

Q. The gas is there, but your line is not sufficient to carry it?

A. That is right."

It has been demonstrated by actual experience that 12 per cent of the open flow of the purchase contract wells can be delivered into the pipe lines in the winter when the line pressure is highest, and this means that the daily amount of gas available to the company with its present set up, is at least 12 per cent of 3,929,532 M. c. f. or 471,555 M. c. f. per day, which is over 70 per cent more than the capacity of its pipe-line system and highest demand it has ever experienced.

This 12 per cent of the open flow is more than double its average daily requirement for the year, when that requirement was greatest, and more than three times its average daily requirement for the year, ending June 30, 1931.

The open flow of the 60 wells of the Company in the Amarillo field, as of July 1, 1931, was 1,532,625 M. c. f. of gas. The maximum capacity of its 20-inch Amarillo pipe line is but 125,000 M. c. f. per day. It will be seen that the company in the Amarillo field has available, based on a 12 per cent take, 58,000 M. c. f. in excess of the capacity of its Amarillo pipe line, and based on a 20 per cent take, more than double the amount of gas that it has facilities to transport from this field.

The Company in its argument in the lower court laid great stress on the fact that after the hearing before the Commission, the Railroad Commission of Texas had made an order limiting the take of gas from the Amarillo field to 4 per cent of the open flow, in an effort to provide a market for the "shut-in" gas in this field. This order never became effective for the Company promptly procured a restraining order against its enforcement and on final hearing before a three-judge court, it was declared unconstitutional (Cities Service Gas Co. v. Terrell, 2 Fed. Supp. 168).

What has there been said as to gas requirements applies only to the sufficiency of developed gas for the company's daily requirements and has no reference to its gas reserves on which it must rely for its future supply.

GAS RESERVES.

By gas reserves is meant the gas actually recoverable from the proven and probable leases. In determining the gas reserves of the Company, the 998,287 acres of prospective leases are not taken into account because of their speculative character.

The Company introduced Exhibit 3, being report by Ralph E. Davis a gas engineer and geologist of national repute, who had been employed by the Company to make an exhaustive survey and to testify as to its gas holdings and gas reserves. This report is bound, contains 98 pages and 14 tables and a map showing its pipe-line system, location of its gas fields, and the gas

acreage held by the company in each county in Texas, Oklahoma and Kansas. It covers, among other things, a list of all of its wells, together with the date when drilled, their initial rock pressure and volume, their rock pressure and volume as of July 1, 1931, their depth, the amount of gas reserve remaining, the amount of gas produced and sold by the company from 1927 to date, a list of its gas purchase contracts, and the open flow of gas from the wells covered by said contracts, and a classification of all of the Company's leases into developed, proven, probable and prospective, and numerous other data, including a statement of the recoverable gas reserves covered by the gas acreage held by the Company, except as to the prospective acreage.

Mr. Davis is the same witness who testified for United Gas and Fuel Company in the case of United Gas & Fuel Company v. Public Service Commission of West Virginia, 278 U. S. P. 322.

A statement of the acreage, classification and the recoverable gas reserve of the Company which is not disputed was introduced by the Company in this Exhibit and is as follows:

RECOVERABLE GAS FROM ALL PROVEN AND PROBABLE ACREAGE AND CLASSIFICATION.

	Estimated Gas Reserves M c. f.	Acreage
Kansas-Oklahoma (except Hugoton and Mo.		
Proven, developed	23,858,000	19,882
Probable	9,566,000	1,020
Total	33,424,000	20,902
Hugoton Field:		
Proven	492,100,000	49,210
Probable	196,490,000	28,070
Total	688,590,000	77,280
Amarillo field:		
Proven:		
Developed	585,600,000	39,040
Undeveloped	836,700,000	55,780
Total	1,422,300,000	94,820
Probable	304,350,000	40,580
Total	1,726,650,000	135,400
Grand total	2,448,664,000	233,582

(R. 486, 487)

It will thus be seen the Company's total recoverable gas reserve from 233,582 acres of proven and probable acreage, including that acreage in Kansas, Oklahoma and Missouri, 20,902 acres; the Amarillo field, 135,400 acres; Hugoton field, 77,280 acres; is 2,448,664,000 M. c. f. of gas and that 98 per cent of this recoverable gas is in the Amarillo and Hugoton fields, of which in excess of 70 per cent is in the Amarillo field.

That part of the Amarillo field known as the proven Sweet gas area is 130 miles long, from seven to forty miles wide, containing approximately 1,001,785 acres, all of which is proven and in which no dry hole has been encountered. Wells come in in this field producing from 6,000,000 to 170,000,000 cu. ft. of gas per day. It is the most gigantic and most prolific gas field ever discovered.

Davis testified that the gas-producing sand over the entire proven Sweet is 70 feet thick on the average, and that the recoverable gas, that is, the amount of gas which can be taken out after leaving 20 per cent of the gas in the ground, is 15,000,000 cu. ft. per acre, and stated that this estimate is low and that it is possible that from one and one-half to two times this recovery of 15,000,000 cu. ft. of gas per acre will be obtained. (R. 486)

Davis testified that although some of the wells of the Company in Carson County had been producing into its pipe line for three and one-half years, the average rock pressure on July 1, 1931, had diminished only 6 lbs., from 412 lbs. to 406. (R. 492)

Based on the assumption that the company annually will be required to produce from its owned gas leases as much as it produced from them in 1930, to-wit: 34,401,978 M. c. f., the year when it produced and sold its largest amount of gas, its gas reserve in the proven and probable acreage, excluding the prospective, will last for over seventy-one years.

Its proven and probable acreage in the Amarillo field alone is sufficient for fifty years.

Or if the Company should cancel all of its purchase contracts and take all its gas requirements, which for 1930 was 74,163,945 M. c. f., including gas purchased, from its gas reserves its gas reserves would last for thirty-three years.

We believe that from the foregoing it is evident that the Company owns many more gas leases than are "used and useful" and devoted to the use of supplying gas to its customers. It is a fair inference from the facts in evidence that the Company acquired these excess leases expecting to sell them at an enhanced price. The evidence shows that it did sell 59,788 acres of gas leases to the Texoma in 1931, at a profit of more than $1,000,000.00. (R. 480)

GAS LEASES USED AND USEFUL.

It has been said:

> "The well-established rule of law is unquestioned, that what the company is entitled to demand in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public." (Pond on Public Utilities, Sec. 591; San Diego Land & Town Co. vs. National City, 174 U. S. 757; 43 L. Ed. 1154)

We believe this is a correct statement of the law and that the mere fact that the officers of the company have testified that they consider all of the 1,262,361 acres of gas rights owned by the Company as a necessary and a prudent purchase, is not conclusive that all of these

gas leases are presently used and devoted to the public use, if the physical facts show, as we contend they do here, that all of these gas rights are not now used, and that the present rate payers do not and will not in the near future receive any benefit from most of them.

This is not saying that the officers are to be criticized for purchasing these leases, nor is it contended that if the time ever comes when said gas rights are in fact devoted to the public use, they should not then be included in the rate base on which to earn a return.

As was said by Rose, C. J., in United Gas and Fuel Company v. Public Service Commission of W. Virginia, 14 Fed. (2d) 221:

> "At the risk of tiresome repetition we can say that we do not criticize plaintiff for acquiring any or all its gas rights. It was doubtless wise to get them. All that we decide is, that, in arriving at the rate base upon which plaintiff is entitled to a fair return, we may not combine two opposing theories. We are not justified in saying that, because plaintiff's investments in gas reserves were prudent, its reserves immediately went into use, and that therefore plaintiff is entitled to have them appraised at the many times higher value it says they now have."

The Commission found that of the Company's acreage, only the following was used and devoted to public use: 50,000 acres in the proven sweet gas Amarillo Field, of which 45,830 acres are blocked and 4,170 acres are not blocked. In addition, all of the developed and probable acreage in Kansas, Oklahoma and Missouri (except the Hugoton field) 21,267 acres, total 71,267 acres, valued

by the Commission at $2,874,390.00, and included this value in the rate base and excluded the value of the remaining acreage. (R. 150)

In this 71,267 acres, found to be "used and useful" are included:

(1) All of the Company's developed acreage, wheresoever situated; Amarillo, 22,090 acres, with 60 wells; Kansas, Oklahoma and Missouri, 20,207 acres, with 244 wells.

(2) 27,910 acres proven, undeveloped acreage in the Amarillo proven sweet gas area.

(3) All of the probable acreage in Kansas, Oklahoma and Missouri, 1060 acres (except Hugoton field).

That is, this 71,267 acres comprises 50,000 acres proven in the Amarillo field with all the wells in that field, and 21,267 acres, all of the developed, proven and probable acreage in Kansas and Oklahoma, (except Hugoton), containing all the wells owned by the Company wherever situated.

The recoverable gas reserve in this 71,267 acres, according to the testimony offered by the Company is:

	M c. f.
50,000 acres—Amarillo	750,000,000
21,267 acres, Kansas, Oklahoma and Missouri	33,424,000
71,267 acres	783,424,000

(R. 486) which is sufficient to furnish all of the Company's requirements, excluding the gas purchased under

its purchase contracts, on the basis of its requirements for the year, 1930, for twenty-two years, plus.

$$\frac{783,424,000 \text{ M c. f.}}{34,401,978} = 22 \text{ plus}$$

The Commission has thus excluded from the rate base the following:

	Proven	Probable	Prospective.
Amarillo field	44,820	24,547	.....
Hugoton (Kansas and Oklahoma) (Company's Classification)	123,440	.....	.....
Prospective—all	.....	.....	998,287
Total	168,260	24,547	998,287
Grand Total			1,191,094 acres

All of this excluded acreage is undeveloped.

The acreage in the Hugoton field excluded comprises 123,440 acres, classified by the Company as all proven; classified by the Company's expert, Davis, as 49,210 acres proven, 28,070 acres probable; by Holl, for the Commission as 84,367 acres proven, 32,008 acres probable, and 7,065 acres prospective.

None of the company's acreage in this field is drilled, and all of it is distant at least ninety miles from any pipe line owned by the company. It is held by the company through leases which run for ten years with now about seven years to run. These leases require that an annual rental be paid and that a well be drilled within

the term of the lease, or it will expire. The number of these leases is in excess of 500.

The cost of drilling and equiping a well in this field is not less than $20,000, and if the Company is to hold these leases, it must drill within the next seven years over 500 wells at a cost of over $10,000,000, and in addition pay an annual rental in a substantial amount.

The prospective acreage excluded amounts to 998,287 acres, and has already been described. As stated, it is "wild-cat" territory. Its value, if any, is for oil and not gas, is scattered, and very little of it is available to the company's pipe line. It was not included in estimating the gas reserve.

In the allotment of 71,267 acres of leases as "used and useful", there are 28,970 acres of land in the proven sweet area of the Amarillo field, which are not developed, and 1,060 acres in Kansas, Oklahoma and Missouri which are probable and undeveloped, making a total of 29,295 acres in the acreage assigned as "used and useful", which the company may in the future develop as that becomes necessary.

It will thus be seen that by the allotment of the 71,267 acres to the company as presently "used and useful" there has been included all of the Company's developed gas acreage and wells wherever situated; all of its proven and probable acreage in Kansas, Oklahoma and Missouri, (except Hugoton), with a recoverable gas reserve of 783,424,000 M. c. f. as follows:

SUMMARY OF GAS LEASES—USED AND USEFUL.

DEVELOPED.	Acre	Wells	Recoverable Gas M. c. f.
Amarillo	22,090	60	331,350,000
Kansas, Oklahoma & Missouri	20,267	244	33,858,000
PROVEN UNDEVELOPED			
Amarillo	27,910	None	418,650,000
PROBABLE			
Kansas and Oklahoma	1,060	None	9,566,000
	71,267	304	783,424,000 M. C. F.

with sufficient reserves of recoverable gas to last (on the basis of its requirements for produced gas in 1930) for over twenty-two (22) years. In addition to this reserve, the Company owns purchase contracts entitling it to the gas from 782,421 acres in Kansas and Oklahoma, having 1,502 wells and a daily open flow of 2,138,170 M. c. f.

To us it seems unjust to require the present gas consumer to pay a rate for gas based on a return on the valuation of leases which are not used for them, and which if ever used will not be until the distant future. To do so would permit the utility to speculate in leases at the expense of the consumer, for it is the practice of the company to charge as an expense the cost of leases which prove worthless, and the expense of dry holes, but when the lease proves valuable, to add the increased value over its cost, to the rate base, and where the leases are sold at a profit, not to include the profit in its earnings, as

was the case in the sale of leases and wells to Texoma where the Company realized a profit of over one million dollars.

The gas situation has undergone a complete change within the last five years. The Amarillo and Hugoton fields have been developed within that time. Prior to that time the problem was how and where to get gas, and utilities based their rates on the agreed presumption that the gas supply would be exhausted in from seven to ten years, and asked to amortize their entire property within that time.

Now the problem is to find a market for surplus gas.

Doctor Raymond C. Moore, State Geologist, of Kansas testified that the recoverable gas in the Hugoton field alone is sufficient to supply all of the requirements of Kansas, domestic and industrial, at the present rate of consumption, for over one hundred years.

Since the hearing before the Commission, the Burton field—about twenty-one miles from Wichita and eleven miles from Hutchinson, Kansas, has been discovered. Its limits have not yet been defined. At the time of the hearing in the lower court it had wells with an open-flow capacity of 270,000,00 cu. ft. per day, with a rock pressure of 1,200 lbs. Since that time the field has been greatly extended. The Company has a pipe line within three miles of this field which is connected to two of the wells in this field. (R. 489)

The problem confronting the Texas railroad Commission in the Amarillo field is how to conserve from waste and to provide a market for the vast amount of "shut-in"

gas, that is, gas wells which have been drilled by independent operators which are shut in for lack of market.

The first attempt to provide a market for this "shut-in" gas was by the common purchaser act, which required the gas companies to purchase pro rata this gas. When that was declared unconstitutional, (Texoma Natural Gas Co., v. Railroad Commission, 59 Fed. (2nd), 750) the Texas Commission made its recent order referred to by the Company in the lower court, limiting the "take" to 4 per cent of the potential (open flow).

The object of this order was to provide a market for this "shut-in" gas. Since the decision of the lower court, this order has been declared unconstitutional (Cities Service Company v. Terrell, 2 Fed. Supp. 168, supra), and the take now is only limited to 25 per cent of the open flow.

The action of the Commission in including in the rate base only that acreage which presently and in the near future will be "used and useful" is in accordance to the established practice and is supported by the authorities.

AUTHORITIES.

In the case of Spring Valley Water Co. v. San Francisco, 165 Fed. 667, decided October 7, 1908, District Judge Farrington said (at page 697):

> "It is not just to compel consumers to pay for more than they receive, or to pay complainant an income on property which is not actually being used in gathering and furnishing water. If in this case the company, in anticipation of the growth of the

> city and its future needs, acquired property for future use at a cost of hundreds of thousands of dollars which is now worth millions, it has acted wisely, but it should be satisfied with the goodness of its bargain and the enhanced value of its property without asking in addition gratutities from its customers in the way of higher rates. When the property does come into necessary service, the company is entitled to have it credited at its then fair and reasonable value for rate-fixing purposes."

In Acquackanonk Water Company v. Board of Public Utility Commissioners, 100 N. J. L. 169, Affirming 1. N. J. Mis. R. 575, 125 Atl. 33, P.U.R. 1924 E, 436, decided May 19, 1924, the New Jersey Court of Errors and Appeals affirmed a judgment of the Supreme Court which had affirmed the Commission's order. On the matter of unused property the court said (at page 438, P. U. R.):

> "The first point made by the water companies is that the Board erroneously reduced the value of the property by excluding one-half of the value of the Kikeout reservoir. But the evidence shows that such reservoir property is a mere site, not useful or used at all in supplying water at present, and possibly never may be. The complaint which the companies make is that only one-half of the value of this reservoir was taken in consideration. Under the circumstances as disclosed by the evidence, the allowance of one-half its value was all the prosecutor is entitled to, and is, we think, unobjectionable from any point of view."

In Chesapeake & Potomac Telephone Company of Virginia v. Commonwealth, 136 S. E. 575, decided January 20, 1927, the Supreme Court of Appeals of Virginia upheld the Corporation Commission in excluding from the

rate base of the telephone company a valuable corner lot purchased for telephone purposes but not yet put in use. President Prentis for the court said (at page 579):

> "Among the items of property which the company claims should be included in the rate base is a valuable lot upon the corner of Seventh and Grace Streets, Richmond, which was purchased three years ago, on December 4, 1923, at a total cost of $286,475.33. This area, excepting a small strip used as an alley, is not now used for any telephone purpose. Part of it is occupied by old residences, and part of it is vacant. The estimate of the present value of this particular lot, exclusive of the use of the alleyway, by a witness for the company, is $319,185.50, and by another expert witness a larger amount. The company contemplates ultimately using this property for telephone purposes. It is adjacent to a valuable building heretofore constructed and now so used. It is said that the company will probably start with that project within the next two years. The forethought which led to the purchase of that property is commendable, but it is no financial burden, for it is shown to be rapidly increasing in value. We think that the Commission did not abuse its discretion in holding that this property is neither used nor useful in the public service, and therefore that its cost should form no part of the present rate base. To hold otherwise would be to charge the public with rates based thereon. It must have some annual value, and the additional profit to the company from its rapidly increasing fee simple value is surely sufficient immediate reward to the company for its foresight. It has no proper place in the rate base valuation upon which the company is presently entitled to receive additional rates from the public for telephone service. The Commission has therefore deducted the price of this property from the estimated rate base."

Re Grangeville Electric Light & Power Company, P. U. R. 1922 D, 513, decided June 24, 1922, was an electric rate case before the Idaho Public Utilities Commission. The proposed rate increases were disapproved. On the subject of excess cost of dam construction, the Commission said (at pages 520-521):

* * * * *

"This Commission cannot presume to take over the management of applicant's property, nor dictate to applicant as to method of construction or amount of expenditures but neither can it permit the applicant to earn a return on an injudicious or unreasonable investment. The applicant may, through a vision of future development of territory, and business to be attached, or for some other reason, have felt fully justified in building for the future, but, if so, it must be satisfied to await such development and additional business for return on investment over that reasonably necessary and required to provide for the demands of the present and immediate near future. In the light of the facts before the Commission, and considering all the circumstances surrounding and conditions relating to the rebuilding of said dam, including the demands of existing service, the Commission believes that there is an excess of cost in said dam over the immediate or near future demand of applicant's service of $115,304.05 which, while a real value, is not now and will not be for a considerable time used and useful in service and therefore must be considered as inoperative property until such time as the demand requires the installation of other generating units and we therefore deduct the sum of $115,304.05 from the value found in establishing the value of the property now used and reasonably necessary and required in the service of the public to be used as a rate base."

In the case of the Columbus Gas & Fuel Company, No. 5635 P. U. R. 1933A, 337, decided in October, 1932, by the Public Utilities Commission of Ohio, the Commission held that only the operated or drilled acreage was "used and useful" and excluded all the undrilled and proven acreage.

The operated or developed acreage which the Commission included consisted of 291,386 acres. The Commission arrived at the number of acres by multiplying the number of wells, which was 3,659 by 79.7 which was the number of acres which the Commission considered one well would develop.

The acreage which was disallowed by the Commission was 2,252,791 acres. This was excluded on the ground that it was undeveloped and therefore not "used and useful."

The Company valued this excluded acreage at $24.752,000.00.

The Ohio Commission valued the operated or developed acreage at $25.00 per acre.

In deciding this case the Ohio Commission held that the present rate payer should not be penalized by a higher rate to take care of a future rate payer.

The expense of rentals on unproducing leases was disallowed, but the Commission held that when this acreage became producing the expense of these leases, including carrying charges should be added and capitalized and go into the valuation.

City of Erie v. Public Service Commission, 278 P. 512, 123 Atl. P. U. R. 1924 D, 89, decided January 1, 1924.

was an appeal from the superior court affirming an order of the Pennsylvania public service commission in a natural gas rate case. The main controversy was over gas holding, which were included in the rate base at a valuation nearly $6,000,000 lower than the lowest estimate of their value shown by the testimony in the case *** On the subject of the property to be included in the rate base, the court said:

> "The Commission correctly summarized the law in these words: 'Gas holding should be included and evaluated only to the extent that they represent *developed, used and useful territory,* including a reasonable reserve for the continued functioning of the company in its public service.'"
>
> * * * * *
>
> "*However, the present value of all the property is not necessarily to be considered in the rate base.* Generally speaking though property may have the value claimed, if a reasonable proportion of its energies or the used and useful property *is not devoted to public service,* it should not ask the consumer to pay a return on the *excess not used in public service,* allowing, of course, for a reasonable *reserve.*
>
> * * * * *
>
> "There can be no graduated values of gas lands fixed as a rate base under any theory presented to us that will consider property presently used and a descending ratio until exhaustion appears that is not the result of the pure guess. Beyond that proportion of the *lands reasonably necessary to the company's life, the rate payer should not be required to assume the remainder as a burden.* Though this may be difficult to determine, the commission, acting as an administrative body in each case, must decide the question, as in all other matters subject to the right of appeal."

* * * * *

"One thing of importance must not be lost sight of. Whether the gas lands be valued or considered on a reservoir or acreage basis, the gas is not paid for as gas until it is brought to the surface and used. In addition to the fair return on the rate base as found there is added payment for the corpus of the estate taken away, or gas that is taken out, used, and cannot be replaced. This is taken care of in an allowance for 'depletion.' The fair return on the rate base is a fair return to the company for the money invested."

* * * * *

"The purchase of additional gas rights, treated as 'operating charges,' places on the present-day consumer an undue burden, particularly when the prices paid are high. It enables the company to recoup immediately its capital outlay. If, in addition, we carry forward the cost as a part of the rate base, or recovery is permitted through depletion, then we allow an additional return on capital already in the pockets of the owners."

* * * * *

"While some rules as to lands for future use must prevail, its determination is primarily for the commission."

(Italics added)

In the case of Logan Gas Company v. Public Utilities Commission of Ohio, 169 N. E. 575, the Supreme Court of that state approved the findings of the Commission, which included the value of leases having producing gas wells drilled thereon, and which rejected and excluded from the rate base all leases under classes 2, 3, and 4, being leases on which there was no development. The court said:

"As to class No. 2, to-wit: Leases or tracts of land proved by actual developments and operations in the immediate vicinity thereof to be good gas-producing lands, *but which do not have any producing wells drilled thereon*, the majority of the court is of the opinion that while these leases upon territory of such character may in the future be 'useful', the same do not come within the purview of the statute which requires the property to be given valuation to be both 'used' and 'useful'.

"The leasehold covering such character of territory not being both 'used' and 'useful', the commission's views upon that point are affirmed."

(Italics added.)

United Fuel Gas Company v. Public Service Commission of West Virginia, 14 Fed. (2d) p. 209:

This was on a bill in equity before a three-judge court to enjoin the Commission from enforcing its order with reference to rates for gas, on the ground that by the orders of the Commission complainants property was being taken from it without due process of law. The court made detailed findings and denied the application for an interlocutory injunction.

The principal issue was the value of the gas leases. The Gas Company controlled the production of natural gas from 814,910 acres of land.

The lower court included in the rate base the assessed value of only 136,384 acres (proven), which were then being used in production, and excluded on the ground that they were not presently used and useful in the public service, 126,208 acres described as probable, and

552,319 acres classed as improbable or unfavorable, valued by the Gas Company at $26,000,000.00.

In the decision by Rose, C. J., it was said:

> "Among the questions raised by the claim of the plaintiff, that the value of the gas under the various classes of acreage shall be *treated as a part of* the value *upon which* it is entitled to a return are:
>
> First, What is the amount of gas under each class?
>
> Second, What is its present value?
>
> Third, How much of that value is presently used in the public service?" (Italics added.)

In discussing these questions the lower court further said:

> "Its right to relief is nevertheless absolutely dependent upon its being able to maintain the position that it is entitled to a fair return upon the present value of such of its property as is *used and useful* in the public service. Whether it showed good judgment in acquiring and holding any other property is irrelevant to any issue upon which it here seeks a decree. No part of the gas which is supposed to be under the acreage classed as either probable or possible is '*used*' in the public service or for that matter in any other, in any ordinary sense of that word."

> "It will be noted that the total of the gas underlying the proven acreage was 249,100,100 M. c. f. As the plaintiff sells annually about 47,000,000 M. c. f. of which 10,500,000 goes to the West Virginia retail purchasers, it has under its proven territory gas enough for everybody for more *than five years*, and an amount sufficient to meet the needs of its public service patrons along for almost a quarter of a century."

"For the reasons already stated, we cannot see how any other portion of its gas can be held to be used in the public service, no matter how elastic a definition be given to the word 'used'. At the risk of tiresome repetition, we can say that we do not criticize the plaintiff for acquiring any or all its gas rights. It was doubtless wise to get them. All that we decide is that, in arriving at the rate base upon which plaintiff is entitled to a fair return, we may not combine two opposing theories. We are not justified in saying that, because plaintiff's investments in gas reserves were prudent, those reserves immediately went into use, and that, therefore, plaintiff is entitled to have them appraised at the many times higher value it says they now have. If, in dealing with its tangible property, and going concern value, we are required to ignore, except for check purposes, plaintiff's investment in them, we must apply the same rule to its gas reserves."

It will thus be seen that the court decided squarely that only the developed acreage should be included in the rate base, and excluded from the rate base 80 per cent of the Company's acreage, valued by it at $26,131,865.00.

The decision of the three-judge court, denying an interlocutory injunction, was affirmed by this court, United Gas & Fuel Company v. Public Service Commission of West Virginia, 278 U. S. p. 322, 73 Law Ed. (U. S.) p. 402.

In United Fuel Gas Case, the reserves of the Company were 249,100,000 M. c. f. and its annual requirements were 47,000,000 M. c. f. In other words, the reserve alloted to the Company was sufficient for only five years. In the instant case the gas reserves in the used

and useful territory was 783,442,000 M. c. f. and the Company's highest requirement per year for produced gas (excluding the purchased gas) is 34,401,978 M. c. f., and this reserve is sufficient for twenty-two years.

We submit that the Commission was justified by the facts in holding that only 71,267 acres of its gas reserves (which are in addition to its purchase contracts, covering 782,421 acres and 1,502 wells, with a potential of 1,532,625 M. c. f.) per day, are used and useful to the Company's rate payers. This allotment includes not only all of the Company's developed acreage and wells, but also 28,970 acres of undeveloped acreage, 27,910 acres of which is in the proven sweet gas area of the Amarillo field. We contend that the fact that the officers of the Company have testified that they consider all of the 1,262, 361 acres held by the company as necessary for its future requirements, is not sufficient to overcome the actual facts, as shown by the undisputed evidence of the Company, that the acreage found as used and useful is sufficient for all of the Company's requirements (on the basis of its greatest demands) for 22 years in the future. We believe that it is not just to require the present consumers to pay for gas reserves which are not now used, and which will not be called for use (if ever) until the distant future.

We respectfully submit that the finding of the Commission that only the value of 71,267 acres designated by it should be included in the rate base and that the value placed on this acreage by the Commission at $2,874,390, should be sustained.

HYPOTHETICAL PIPE LINE.

The Company introduced an exhibit prepared by the chief engineer for Ford, Bacon and Davis, purporting to show the cost of acquiring the reserves, constructing and putting into operation a substitute for the present pipe line system. The testimony pertaining to this exhibit is to be found on pages 533 to 538 of the record.

The witness testified that the hypothetical pipe line system is comparable to the present system only in that it will serve the same markets; that no check of the present system was made to find out whether it had more or less capacity.

He testified further:

> "That no consideration was given to gas supplies in Kansas and Oklahoma; that in designing an actual project any available gas closer than Texas would be taken into consideration. That the witness did not attempt to design a project contemplating any supply of gas from Kansas or Oklahoma and could not estimate the difference in price without refiguring the entire project." (R. 354, 533)

The Commission upon consideration of the evidence pertaining to the hyopthetical line was of the opinion it should be given no weight because in preparing the hypothetical pipe line no consideration was given to the fact that 50 per cent of the pipe line company's supply of gas was obtained in Kansas and Oklahoma, near the market, and because of the failure to give consideration to local gas. The engineer provided for two parallel 24 inch lines from the Amarillo field, while on account of local

gas only one line and that a 20 inch line is now present in the system from the Amarillo field. There was no occasion for construction of two 24 inch lines to the Texas field in view of the fact that the Company had a large amount of local gas available in Kansas and Oklahoma. This hypothetical pipe line covers a different plan and a different system and was more expensive to construct because the engineer in his estimate, went farther than necessary to obtain the gas.

Assigned Error No. 5.

PRESENT VALUES AND PRUDENT INVESTMENT

The Majority Court found that:

> "The present values are on the extensive constructions of the last few years, less than the prudent investment therein." (R. 302)

We do not so understand the evidence.

Exhibit 82 which is set out in the record, throws some light on this comparison.

COMPARISON OF COSTS ON CONSTRUCTION OF WICHITA-OTTAWA 20 INCH LINE.

	As per Company J. O. 12145	As per Black and Veatch	As per F.C. Hamilton Valuation
1. Materials	$2,129,143.27	$.....	$.....
Freight	38,202.17	.....	.....
Warehouse Expense	602.20	.....	.....
	2,167,947.64	2,029,812	.....
2. Labor	806,310.82	.....	.....
Garage, teaming and trucking	9,797.92	.....	.....
	816,108.74	1,008,340	.....
	$2,984,056.38	3,038,152	3,572,723
3. Right of way and damages	58,427.40	54,489	191,775
A	$3,042,483.78	$3,092,591	3,764,498
4. Engineering	302,768.30	154,630	*178,636
B	.....	.....	$3,943,134
5. Legal	2,150.49	**61,852	***19,715
Expense Accounts	11,783.71)		
Incidental Expense	4,378.92)	.....	****39,431
Telephone	744.15)		
B.	$3,364,309.35	$3,309,073	$4,002,280
6. Interest	24,444.01	198,544	320,182
Totals	$3,388,753.36	$3,507,617	$4,320,460
Deduct items not charged to main line construction	$ 13,643.26	.....	.....
	$3,375,110.10	$3,507,617	$4,320,460

* 5 per cent of line B column "Hamilton" x $3,572,723
** Calculated at 2 per cent of A column "Black & Veatch, and includes administration expense x $3,092,591.
*** One-half of 1 per cent of line B column "Hamilton" x $3,943,134.
**** Applies to $3,943,134 at 1 per cent. (R. 425-426)

This comparison covers the construction of one of the Company's major projects before decline in prices and shows the actual cost of the Wichita-Ottawa line was $3,375,110.10 and that Black included the line in his appraisal at $3,507,617, and Hamilton included it in his valuation at $4,320,460.

The exhibit shows the actual cost of materials, freight and warehouse expense was $2,167,947.64, while Black included for the same items of cost, $2,029,812.

The actual cost of labor, garage, teaming and trucking as shown by the books, was $816,187.04, while Black included the same items in his appraisal at $1,008,340.

A comparison of labor, garage, teaming and trucking costs to the Company with Black's value shows that Black valued these (items at $192,232 more than the actual cost to the Company. The contractor who laid this line for the company testified that he lost approximately $128,000 on this contract, (R. 420) and under the contract he furnished the labor, teaming, etc. This substantiates to a large extent Black's value, which is $192,232 more than the actual cost.

Hamilton's valuation did not show a breakdown of the above items; his total value for them is $3,572,723, compared with Black's value of $3,038,125, and the actual

cost of these items, as shown by the books of the Company, of $2,984,056.38.

Right of way and damages on the Wichita-Ottawa line cost $58,427.40, according to the books of the Company. Black included $54,489 for right of way and damages, while Hamilton included $191,777 for the same items.

Engineering expense on this line, including Henry L. Doherty and Company's 5 per cent fee, cost $302,768.30, according to the books. Black allowed for engineering on this line $154,630, while Hamilton included in his percentage allowance for engineering $178,636.

Legal, miscellaneous, incidental expenses and telephone expenses charged to this line on the books of the Company amounted to $19,057.27. Black allowed $61,852 for these items in administration expenses, while Hamilton included $59,146 for comparable items.

The books of the Company show that interest during construction of this line amounted to $24,444.01, which is slightly over 7/10 of 1 per cent of the total cost. Black allowed $198,544 for interest and Hamilton allowed $320,182 for the same item.

We will now leave comparisons of specific construction projects and discuss a comparison of the total present values with the historical values.

A comparison of the values found by the engineers with the book value of the properties is not reliable because there have been writeups on the plant and investment account which were not present in the original investment.

The amount of this writeup could not be ascertained but Exhibit 9 was introduced before the Court showing a writeup of over $9,148,627 in the case of the Kansas Natural Gas Company alone, which was one of the five companies in the consolidation making up the present Cities Service Gas Company.

The exhibit is referred to in the record as follows:

"The annual reports of the Kansas Natural Gas Company filed with the Department of State of the State of Kansas for the years ending December 31, 1921, introduced as Exhibit 8, and December 31, 1922, introduced as Exhibit 9, show the resources, liabilities, capital and reserves of this company at the above stated dates as follows:

	Dec. 31, 1921	Dec. 31, 1922
Total Resources	$12,922,834.61	$23,443,210.00
Liabilities	1,785,551.21	2,572,838.63
Capital Stock	7,700,250.00	6,000,000.00
Surplus	740,522.50	1,568,243.84
Reserves	2,687,510.90	13,302,128.53
Total Liabilities, Capital & Reserves	$12,922,834.61	$23,443,210.00

"'Total Resources' includes the book value of plant investment which was $11,241,229.97, at December 31, 1921, and $20,389,857.72 at December 31, 1922, an increase of $9,148,627.75.

"No new capital was paid in; the combined capital and surplus was less at December 31, 1922 than it was at December 31, 1921." (R. 533)

The total plant investment and other assets including leases of the Cities Service Gas Company is shown to be $96,795,538. This figure includes some leases later sold to the Texoma Company. (R. 375) After deducting the value of the leases sold to the Texoma Company, in the amount of $846,217, (R. 372), the total plant investment and other assets including leases is $95,949,321.

When the writeup of which we have knowledge in the amount of $9,148,627 is deducted we have an historical cost of $86,800,694. Reducing that figure by 10 per cent to arrive at the depreciated value for the purpose of comparing it with the depreciated value found by the Court, we have a depreciated value of $78,120,625.

The Court found a present depreciated value of $82,380,583, which is $4,000,000 more than the historical value or prudent investment value depreciated. Even when an addition is made for Going Value the two figures remain comparable.

Approximately $46,000,000 of this historical value, or actual cost, was added to the plant during the years 1926 to June 30, 1931. (R. 533) This period represented the peak of high prices.

We submit that the present values as found by the engineers are as great or greater than the prudent investment or original cost to the Company when consideration is given to the writeups on the books of the Company. The least that could be said is that the evidence more nearly supports the majority Court's statement in its finding XII that:

"The original cost, or prudent investment, in the pipe line Company's properties is somewhat obscure." (R. 301)

than the positive statement in its finding XIII that:

"The present values are, on the extensive constructions of the last few years, less than the prudent investment therein." (R. 302)

Assigned Error No. 6.

CONCLUSION AS TO VALUATION.

The Commission found a depreciated value of $73,170,510 as of September 1, 1931. (R. 374)

The Commission depreciated overheads. It is stipulated by the parties that overheads should not be depreciated because no annual allowance was provided for overheads.

Accordingly there should be added to this value on account of depreciation of overheads the following:

Engineering and Superintendence during Construction	$ 337,585
Administration and Legal Expense during Construction	36,010
Miscellaneous Construction Expense	72,019
Taxes During Construction	97,127
Interest During Construction	468,652
Total	$1,011,392

When these are added this makes a total depreciated value as of September 1, 1931 of $74,181,902.

We submit that the value of all the Company's properties did not exceed this amount on that date.

Although the valuation was made by the engineers in the summer of 1931, they did not use depressed prices then prevailing.

Black testified:

> "It was not my idea in making this appraisal or fixing these prices to use rock bottom prices of labor or material." (R. 374)

The rate of earned income during the test period in this case was abnormal, the lowest in the experience of the Company, yet the rate base to which it was applied was calculated on normal prices.

In the case of Los Angeles G. & E. Corp. v. Railroad Commission, 289 U. S. 287, the Supreme Court said:

> "It is apparent that the estimates of cost of reproduction new of 1929 or of 1930 upon which the Company relies, afforded no secure foundation for predication of future values, and the rate base as fixed by the Commission is not to be invalidated as involving confiscation by reason of these estimates which the course of events deprived of credit as truthworthy prophecies."

RATE BASE DURING EACH ANNUAL TEST PERIOD.

There should be included in the rate base for any period only the value of the property used and useful in earning the net income during such period.

The test period used in the present investigation covered the years 1930 to June 30, 1932.

Earning statements were submitted for yearly periods as follows:

Year ending Dec. 31, 1930.
Year ending Dec. 31, 1931.
Year ending June 30, 1931.
Year ending June 30, 1932.

The investigation was started in the summer of 1931.

From finding of the Commission it appears that the anticipated test period when the investigation was started was the year ending December 31, 1930, and the year ending June 31, 1931.

The statement of the Commission is as follows:

> "At the suggestion of the Company, the two periods used was the year ending December 31, 1930 and the annual period ending June 30, 1931." (R. 168)

However, before the hearing was completed six months had expired and the Company submitted an earning statement for the last six months of 1931. Before the rehearing was completed another six months had expired and the Company submitted an earning statement for the first six months of 1932.

The Commission then used the full test period agreed upon and also the annual period ending June 30, 1932.

The Court in its findings abandoned the original test period and used the annual periods ending June 30, 1931, and June 30, 1932, although it found that 1932 was an abnormal year and stated:

> "We agree with the Commission that 1932 should not be taken as a test year, for it marks, it is hoped,

the low of the depression through which we are passing." (R. 314)

Since November 30, 1926, the date of the organization of the Company, the plant investment has increased over $46,000,000. During this time its large gas reserves were acquired and a 20-inch pipe line was constructed from Amarillo, Texas to Wichita, Kansas. A trunk line was constructed from Hutchinson to Nebraska, and an additional trunk line was laid from Ottawa, Kansas to Kansas City, Mo., and trunk lines were extended into Missouri.

It is obvious that a comparison of net income during 1930 with the value of property used and useful as of September 1, 1931, would furnish no indication of the net return earned during 1930 on the value of the property used and useful during that year, as large additions were made to the property currently during all of that period as well as during the period from December 31, 1930, to September 1, 1931. It must be presumed that additions to the properties were made for the purpose of securing additional revenues or bringing about economies in expenses.

In determining the return earned on property used and useful during 1930, the value of the property used and useful during that period must be found. The only evidence from which such finding may be made consists of the value at September 1, 1931, as testified to by the engineers, and the cost of the net additions from January 1, 1930, to September 1, 1931, as shown by

the books and records of the Company. In the absence of any very radical change in price levels during the period mentioned, the actual cost of the net additions should compare with the value of such additions at September 1, 1931. Therefore the value of the property used and useful during 1930, which produced the net income earned during 1930, may be fairly ascertained by deducting from the value at September 1, 1931, the net additions from January 1, 1930, to September 1, 1931, and adding to such value of January 1, 1930, the average additions during 1930.

The cost of reproduction new, exclusive of gas leases at September 1, 1931, as found by the Commission is $78,171,761.

The record shows the additions made to the investment in the plant on the books of the Company during the test periods used in the investigation as follows:

Net Additions to Fixed Capital:

July 1, 1931, to Sept. 1, 1931	$ 1,362,506
January 1, 1931, to June 30, 1931	777,591
July 1, 1930, to Dec. 31, 1930	10,471,653
January 1, 1930, to June 30, 1930	592,021

(R. 165)

In the absence of any radical change in price levels during the periods the actual cost of the net additions should compare within reason with the value of such additions as included in the valuations at September 1, 1931. This comparison should be particularly apt in view of the fact that the engineers did not use "rock bottom prices."

In determining the value of the property used and useful in each of the annual periods prior to September 1, 1931, the Commission deducted from the value which is found at September 1, 1931, the additions made during the respective prior periods and then found the average value during such annual prior periods by adding the value at the beginning and end of each year, dividing it by two and applying the percentage condition of 89.94 per cent found by the Commission on the testimony of the engineers to be the per cent condition at September, 1931, and then adding the value of the gas leases which was calculated as the same for all periods.

The following values were found for the respective periods:

Year ending Dec. 31, 1930	$ 66,294,147
Year ending June 30, 1931	66,912,061
Year ending June 30, 1932	73,148,510

(R. 56)

The Commission based its calculations on the rate base as found by it after depreciating overheads and it has been stipulated that overheads should not be depreciated. In addition the Commission made an error in adding to materials and supplies. We have adjusted the figures of the Commission to take care of these ommissions and this adjustment in which we have included the value for the year ending December 31, 1931, is as follows:

Year ending Dec. 31, 1930	$ 67,183,628
Year ending June 30, 1931	67,808,300
Year ending Dec. 31, 1931	73,205,808
Year ending June 30, 1932	74,181,902

The manner in which the Commission arrived at the values for the respective periods has not been challenged.

The Company does however, challenge the figures which the Commission used in making the deductions, which were taken from the Company's books.

The Company contends that all of the property included in the rate base as of September 1, 1931, was constructed and in service during all the test period, but had not been carried to the books and placed in the plant and investment account. According to their theory the new construction was carried on the uncompleted job orders for a considerable length of time after the construction was completed.

The testimony will be found on pages 517 to 528 of the record.

All of the testimony was to the effect that there was a large amount of construction completed in the fall of 1930, which was within one of the test periods.

The Commission was not satisfied with the Company's explanation that the construction was completed long before an entry was made on the plant and investment account. The books show the contrary.

The accountant for the Commission presented an exhibit showing the plant and investment account and the uncompleted job orders during the period covered by the investigation.

The correctness of the audit is admitted by the partie (R. 374)

For the convenience of the Court, the audit of the two

accounts for the year 1930 and the six months period ending June 30, 1931, is here set out:

> "The book value of the plant and property of the Company including completed and uncompleted projects was as follows:

"January 1, 1930.

Plant and Investment Account	$83,223,644.18
Uncompleted Job Orders	3,866,372.39
Total	$87,090,016.57

December 31, 1930.

Plant and Investment Account	$95,828,568.34
Uncompleted Job Orders	2,936,895.73
Total	$98,765,464.07

June 30, 1931.

Plant and Investment Account	$96,795,538.93
Uncompleted Job Orders	2,208,457.57
Total	$99,003,996.50

(R. 527, 528)

The Investment in Plant and Property increased from June 30, 1931, to September 1, 1931, the date of the valuation in the amount of $1,362,506. (R. 526-7)

The majority lower Court, in Finding No. XVI, after having found the annual net operating income of $8,401,680 by averaging the operating income for the two years ending June 30, 1931, and June 30, 1932, stated:

> "The Commission still further increased this by assuming that the income of 1931 was earned upon a lesser investment in the properties; accordingly the Commission deducted from its value as of September 1, 1931, net additions to capital as disclosed by the

Company books from January 1, 1930, to September 1, 1931. But this is shown to be inaccurate because additions were not charged to capital until long after the addition was in service; a lag of from one to three years was customary in order to close up all claims growing out of a particular job. During 1931 there was almost no construction; there was some during 1930, but part of that was to replaace existing facilities. There is evidence that there were not to exceed $2,000,000 additions to plant in the test period; and this would be more than offset in the decline of values between 1930 and the date of the valuations." (R. 315)

We respectfully urge that the majority lower Court misinterpreted the evidence as to the amount of additions to plant in the test period, and was confused by the testimony as to the lag occuring between the time the additions were constructed and the time they were placed in the plant and investment account.

The Company books show the Plant and Investment Account

On June 30, 1931,	$96,795,538,
and at the same date the uncompleted job orders,	2,208,457.
Total of the two accounts, June 30, 1931,	$99,003,995.

The Company contends that there was a lag in the uncompleted job orders and that in truth and in fact the $2,208,457 of uncompleted job orders was in operation at the end of the year 1930, and the Company witness, Eastman gives oral testimony to show such lag by stating that all such uncompleted job orders shown on the book account as such on June 30, 1931, were completed and in

operation in 1930. Eastman stated that there was a lag of from one to three years. (R. 517)

The fallacy of such testimony is shown by the 1930 figures herein before set out.

On January 1, 1930, there was on the books in uncompleted job orders, only $3,866,372. Now if there had been no new construction in 1930, and at the end of the year 1930 there were no uncompleted job orders, then it would show that there was a lag on all of such $3,866,372 cost of uncompleted job orders for a year or a portion thereof, and the plant investment account would have increased in the same amount, to wit, $3,866,372.

Furthermore, if the uncompleted job orders increased during 1930, it would have shown new construction and also a lag, but in fact the uncompleted job orders in the year 1930 decreased $929,477, leaving at the end of the year uncompleted job orders in the amount of $2,936,895.

The record shows also that the plant and investment account at the end of the year 1930 had increased from where it stood January 1, 1930, to wit, $83,223,644
until at the end of the year 1930 it stood $95,828,568
Result—an increase in plant investment of $12,604,924

Thus it follows that the $12,604,924 plant investment account increase less the $924,477 uncompleted job order decrease, or sum of $11,675,447 was new job orders and construction begun, completed and entered in the plant and investment account on the books in the year 1930.

Clearly therefore, the Commission was right when it refused to give weight to the oral testimony in the face of the books records on the plant and investment account.

Comparable figures for September 1, 1931, cannot be given because the amount of uncompleted job orders at that date is not in the record. (R. 527-8)

The books having definitely shown that there was $11,675,447 construction during 1930 which was begun and completed, taken through the job orders and on to the plant and investment account in less than a year's time, the oral testimony pertaining to the lag was destroyed and the facts justified the Commission's finding that all of the property was not constructed and in service during the test period. The Company's challenge of the figures which the Commission used in arriving at a rate base for each of the years, and the Court's conclusion as to their inaccuracy thus failed.

NET INCOME BEFORE DEPRECIATION AND DEPLETION.

There is no dispute as to the net income before depreciation and depletion except as to an item of $50,000 for the year ending June 30, 1932, which the Company adds to expense for the purpose of amortizing rate case expense. At the hearing before the lower Court, there was a controversy as to expense because of payments to Henry L. Doherty & Company. The lower Court found the Doherty payments had not been justified by the evidence. There has been no appeal taken from that part of the Court's findings and decree and the controversy is therefore eliminated.

The agreement of the parties as to net income will be found on pages 515-516 of the record.

The net income before depreciation and depletion for the years covered by the test period is shown by the following table:

Year ending Dec. 31, 1930	$8,904,503.04
Year ending Dec. 31, 1931	8,297,060.35
Year ending June 30, 1931	8,810,691.18
Year ending June 30, 1932	7,963,813.98

To the net earning above set out have been added the payments which were made to Henry L. Doherty & Company and deducted by the Company through expense. (R. 516)

Also to the earnings for the year ending June 30, 1932 has been added the $50,000 deducted by the Company for the purpose of amortizing rate expense.

The only evidence justifying any addition for amortization of rate expense was the fact that the Commission taxed $66,935.08 as costs to the distributing company respondents. (R. 58) There was no evidence in the record of any expense to the pipe line company on account of any rate hearing.

ANNUAL DEPRECIATION AND DEPLETION REQUIREMENTS.

ANNUAL DEPRECIATION.

The agreed statement pertaining to annual depreciation allowance is set out on pages 511 to 513 of the record.

The Company presented evidence and exhibits setting forth the amounts claimed for annual depreciation of each classification of physical property. The Commission accepted the percentages contended for by the Com-

pany and applied them to the present cost of production new as found by it. By applying these percentages to the values, the Commission found that the annual allowance for depreciation of physical properties would be $1,894,022, based on the physical property values at September 1, 1931. The Commission then applied the annual allowance for depreciation set forth above to the physical property values which it found at September 1, 1931 and arrived at a weighted average rate of 2.96 per cent. This is accepted by the parties in the agreed statement as follows:

> "The Commission used an average of 2.96 per cent for annual depreciation on all physical properties, which is accepted by the parties." (R. 512)

ANNUAL DEPRECIATION FOR YEARS COVERED BY EARNING STATEMENT.

The Commission found that because of the recent extensive construction of the Company, all of the physical properties as valued by it on September 1, 1931, were not in service during the years covered by the earning statement as has been discussed heretofore.

As pointed out in the discussion relating to the rate base and the values which should be included in the rate base for comparison with the rate earned during a stated period, the annual allowance for depreciation should be based upon the average value of the physical properties used and useful during each of the earning periods considered.

Applying the agreed rate of 2.96 per cent to the reproduction cost new found for each of the periods under

consideration results in the following allowances for annual depreciation of physical properties:

Year ending Dec. 31, 1930	$1,693,312
Year ending June 30, 1931	1,712,216
Year ending Dec. 31, 1931	1,862,784
Year ending June 30, 1932	1,894,022

It is our contention that the Commission's method of calculating the annual requirements for depreciation during each of the years is logical if the property was not constructed so as to be in service during the years used as a test period, and that no allowance for depreciation should be made in excess of the amounts set forth above for the respective periods.

ASSIGNED ERRORS Nos. 15 and 16.

Annual Depletion Requirements—Gas Leases.

By assigned Error No. 15, appellant complained of the allowance of $329,917.00 as an annual replacement requirement on account of rentals on non-producing leases, (Finding No. 16), and by Assignment No. 16, it complained on account of the findings of the Court and its allowance of $174,747.74 as an annual allowance for dry hole expenses.

The Company claimed an annual allowance for annual reserve requirements pertaining to Gas Leases, as follows:

General development expense capitalized	$532,530.77
A mortization of nonproducing leases	314,981.68
Dry-hole expense	174,747.74
Depletion of producing leases	70,509.88
Total	$1,092,770.07

This large annual depletion requirement which the Company claims for gas leases, is due largely to the fact that the Company carries 998,278 acres of prospective leases which are not even proven to be capable of producing gas and which in most instances are so far removed from the pipe line that they are not available to the present system.

The accounts entering into the depletion requiremnets will be discussed in their order.

ASSIGNED ERROR No. 15.

General Development Expense—Capitalized.

The Company claimed an annual reserve allowance of $532,530.00 for general development expense capitalized.

Eastman testified that this item includes the following character of expenditures: cost of acquiring leases; geological expenses; lease rentals.

The cost of acquiring leases was made up of salaries and expenses of men engaged in acquiring leases and scouting expenses.

The item of $532,530 represents the expenditures for leasehold development charged to capital investment during 1930. These general development expenses are capitalized.

The above amount is estimated as the future annual expenses for leases for those purposes. The Commission in their valuation of leases have included not only the cost of leases but in addition all expenses for geological investigation, scouting and other expenses in pro-

curing said leases and, in addition to this, have included an enhanced value as of September 1, 1931, in the valuation which they have fixed as the fair market value of these leases as of that date. If the Company were allowed this amount as an annual expense and in addition a return is allowed on the value of the leases, which includes these expenditures, there would then be a duplication of charges, that is, the expenditures would be included in the expenses in the first instance and included in the rate base for return in the latter, and we believe that all of this amount should be disallowed.

The Court found with the Commission that no annual allowance should be made for the cost of acquiring leases and geological expenses but allowed $329,917 as an annual replacement requirement on account of rentals on non-producing leases. (Finding No. 16, R. 314)

The Commission allowed only $1,060 for this account. (R. 160)

The difference or increases is $328,857 over the allowance by the Commission. The effect of this increase by the Court is to reduce the net income of the Company in the sum of $328,857.

(The evidence as to this account is found at record page 514.)

Leases such as are owned by the Company require the payment of yearly rental until a producing oil or gas well is drilled, such rental amounts to from fifty cents to one dollar per acre per year, for both the oil and gas rights. The allowance of $329,917 made by the Court includes all of the 1,262,361 acres of Gas Leases, of which

only 42,297 acres are developed and producing gas. In the leases held by the Company on which rentals are required to be paid there are 123,440 acres in the Hugoton field which are more than 90 miles from any pipe line of the Company. They cannot be used until a pipe line is constructed which would be such a major change as to change the entire system of the Company. There are also included nearly a million acres of "prospective" or wild cat leases which are scattered, whose value, if any, is for oil and not for gas.

However, if the contention of the State that but 71,267 acres of these gas leases are devoted to public use and entitled to become a part of the rate base, then this amount should be reduced to cover rentals on only that part of "used and useful" leases for which the Company will be required to pay an annual rental.

Producing leases pay no annual rental. The compensation for such leases is the royalty, which is included in expenses by the Commission and the Company. Inasmuch as in the acreage assigned to the Company as "used and useful" 42,297 acres are developed and producing gas, there will be no annual rental requirement for these leases. This leaves, out of the 71,267 acres of leases assigned as "used and useful" 28,970 acres which are not developed and not producing gas. Of these, 27,910 acres are in the sweet proven area of the Amarillo field. They are part of the blocked acreage in the Burnett lease, and are part of the 50,000 acres in the Burnett lease assigned to the Company in the Amarillo field. As we have seen, the Company is required to pay

$50,000 per year as an annual guaranteed royalty in lieu of an annual rental for the acreage covered by the Burnett lease. (R. 479) This annual guaranteed royalty is charged by the Company as an expense of operation, so that the Company will be required to pay no annual rental on account of this undeveloped acreage in the Amarillo field the annual payment of $50,000 guaranteed royalty for the Burnett being in lieu of such rental.

This leaves the 1,060 acres of probable leases in Kansas, Oklahoma and Missouri; as the only leases on which an annual rental is required to be paid. This rental will not exceed $1.00 per acre per year and if the contention of the State is sustained that only the 71,267 acres of leases assigned by it are entitled to go into the rate base then the full requirement for rentals for non-producing leases will amount to not more than $1,060 per year, and there should be added to the net annual income available for return as found by the Court, $328,857.

We respectfully submit that the allowance by the Court should be reduced to $1,060.

Amortization of Non-Producing Leases.

Under this heading the Company sought to include in its annual reserve allowance $314,981.68 for amortization of non-producing leases, which it claimed was necessary to amortize the cost of leases owned by the Company which were not producing. For example: In the case of a ten year non-producing lease, one-tenth of its purchase price is to be charged to expense each year

until the expiration of the lease or until a well is drilled, which is to amortize its cost over the period of its life of ten years in case of a ten-year lease. This figure of $314,981 is taken from the books and covers the experience of the Company for the year 1930. The Company thus seeks to have included in expenses, as an annual reserve allowance, the cost of these non-producing leases, and it also seeks to have the value of these leases included in the rate base upon which to earn a return.

The present fair value of the used and useful leases is included in the valuation of the Company's property in the rate base on which the Company will be allowed a return. The present fair value of these leases, as found by the Commission, includes not only the cost, the bonus paid, scouting, etc., but also the additional enhancement in value caused by their appreciation as of September 1, 1931. This, in most instances, is many times the actual cost of the lease. There is, in fact, no depreciation or depletion of an undeveloped lease until it has been drilled and commences to produce gas. As soon as a lease becomes productive an annual expense for depletion is then allowed and provided for under amortization of producing leases. In the meantime if an allowance should be made for amortizing nonproducing leases, the Company would be allowed a return not only on the cost but upon the full fair value of these leases, and it is seen, therefore, that by this contention the Company is seeking to have returned both the cost of the leases through an annual reserve charge and at the same time a return on the fair market value of the leases.

We believe that no reserve allowance should be made so long as the leases are nonproductive. If the Company were allowed for amortization purposes one-tenth of the value of these nondeveloped leases annually, then after five years, it would have had returned to it one half of the fair value of the lease and thus the present consumers would be required to pay for the amortization of these leases and also a return on their full value, although they would have received no gas and no benefit from them. We believe that if the consumers are required to pay a rate for gas based upon fair value of its property, including the fair value of these leases, they should not at the same time be required to pay for the amortization of non-producing leases which are not in fact being depleted by use. If the lease through development becomes productive, annual depletion is then allowed in an item of depletion of producing leases.

The Court agreed with the contention of the Commission and disallowed this item. (Finding 16, R. 317)

ASSIGNED ERROR No. 16.

Dry Hole Expense.

This account is intended to cover the future annual expense of the Company in drilling dry holes upon its leases.

The Commission, for this requirement, allowed $12,000.00.

The Court allowed $174,747.74. (Finding 16, R. 317)

The difference is $162,747.74. The allowance by the

Court is the amount claimed by the Company and is based upon the experience of the Company for the year, 1930.

During the years, 1929 and 1930, the Company was engaged in acquiring its leases and in so doing was required to scout, to drill wells, to determine and locate the gas producing areas and to test those leases procured, by development. During this time many new gas fields were discovered, many of which were considerable distance from the Company's pipe line.

In 1930, the Company drilled ten dry holes on scattered acreage in Oklahoma and Kansas, and one well in Texas, none of which was drilled upon the territory classified herein as "proven".

The Company now has ample proven gas reserve sufficient to last it for many years in the future and its period of scouting and its period of pioneering is past.

The testimony of all of the witnesses, both for the Company and the State, is to the effect that in the area classified as proven, there is little or no likelihood of encountering a dry hole in the development of this proven territory. The evidence discloses that in the proven Sweet gas area of the Amarillo field that no dry hole has yet been encountered.

Because of the above testimony the Commission valued the leases as proven gas leases on which no dry holes would probably be drilled; if the probability of dry holes existed the Commission would have found a lower value because of this contingency.

We contend that it would be unsound to make a material allowance for the future for annual expense for dry holes, when the testimony shows that the used and useful leases are proven. The Commission allowed $12,000.00 for this account which is the average cost of drilling a dry hole. The evidence showed that a dry hole cost from $3,000.00 to $21,000.00, depending upon the area.

If the contention of the state is sustained that there should go into the rate base only the 71,267 acres which the Commission has assigned to the Company as its leases which are devoted to the public use, then a *fortiori* the allowance claimed by the Company and allowed by the Court is excessive, for in this "used and useful" acreage there are only 28,970 acres which are undeveloped, and of this amount 27,910 acres are in the Sweet proven gas area of the Amarillo field, and only 1,060 acres are probable.

We therefore, submit that in any event the annual allowance for dry holes should not exceed the sum of $12,000.00 allowed by the Commission, and that there should be deducted from the amount allowed by the Court the sum of $162,747.74.

Annual Requirement for Depletion of Producing Leases.

The Company claims an annual allowance of $70,509.58 for depletion of its producing leases. The testimony of Eastman, for the Company, was that this figure was arrived at by the operating department, based upon geological information and operating records, but

that he was unable to tell how this amount was arrived at or give a breakdown of this amount, and no information as to how this amount was calculated or arrived at has been given to the Commission.

This amount was accepted by the Commission as correct.

We therefore respectfully submit that the reasonable allowance for annual reserve requirements pertaining to gas leases is as follows:

General Development Expenses Capitalized	$ 1,060
Dry Hole Expense	12,000
Depletion of Producing Leases	70,509
Total	$83,569

which figure should be added to the annual depreciation pertaining to physical equipment for the purpose of obtaining the total allowance for annual depreciation and reserve requirements.

ASSIGNED ERROR No. 18.

FAIR RATE OF RATE RETURN.

The Court erred in its finding and conclusion that approximately 8 per cent return upon the present valuation is necessary for The Cities Service Gas Company at the present time, and that a return substantially lower than that would be confiscatory; (R. 317) and erred in its finding that if abnormality is considered the return must be increased and not decreased. (R. 318)

The evidence pertaining to a proper rate of return will be found on pages 528 to 533 of the record.

For the convenience of the court we are setting out in the brief herein some of the evidence as to the rate of return:

"Testimony in regard to a proper rate of return was given by the witnesses F. C. Hamilton, P. McDonald Biddison and Charles F. Clark for respondents and by C. H. Montgomery for the Commission."

The witnesses for the Company testified that under present conditions a fair rate of return should be in excess of 8 per cent. Montgomery for the Commission testified that a fair rate of return for the Cities Service Gas Company would be from 6 to 8 per cent, and that 8 per cent would be the maximum in normal times.

Through a witness for the Company, "testimony was introduced to the effect that because of the assistance of the holding company, the Cities Service Company, the Cities Service Gas Company has been able to sell its securities at an 'interest rate that was from a half to three-fourths per cent less than anything else that was put out at about that time on a similar project', and in addition to that it gets better terms on its mortgages. It does not have to pay them off in ten years as many of the pipe line companies have had to do with issues that have been put out in the last two years. Because of this, the Cities Service Gas Company was able to sell its 5½ per cent bonds for 96¼.

> 'The company, having ample financial resources, does not necessarily have to issue securities now or six months from now or two years from now. They pick and choose their time when the markets are right.'" (R. 530)

We admit that excessive past profits cannot be used as a gauge for future rates. For the purpose only of throwing some light on what return may be expected for the Company in the future, we submit a resume of the Company's financial history.

"Montgomery's Exhibit 49 shows the financial history of the pipeline system under consideration beginning with the organization of the Cities Service Gas Company to date. The Cities Service Gas Company was organized in the latter part of 1926, acquiring the assets and assuming the liabilities of the following companies:

Empire Natural Gas Company
Kansas Natural Gas Company
Empire Gas and Pipe Line Company
Kansas-Oklahoma Gas Company
Empire Gas & Fuel Company (Delaware)
(Gas properties only.)

"The stock control of these companies had been theretofore acquired by Cities Service Company and their assets were acquired and liabilities assumed by the Cities Service Gas Company as of November 30, 1926. Balance sheets of the companies at the time of consolidation are shown on pages twenty-four and twenty-five of Montgomery's Exhibit 49.

"These balance sheets show that at the date indicated the book value of the plant investment of the companies, including uncompleted job orders, was $52,182,525.98, and that reserves for depreciation and depletion had been accumulated out of earnings in the amount of $22,423,936.95. These reserves which had been accumulated out

of earnings amounted to 42.97 per cent of the plant investment.

"These balance sheets show that the companies had accumulated a surplus amounting to $14,903,660.21, which sum is equal to 87.26 per cent of the total capital stock of the companies taken over.

"The combined reserves for depreciation and depletion and surplus amounted to $37,327,597.16, which is equal to 218.55 per cent of all outstanding capital stock of the companies and 71.53 per cent of the plant investment.

"In the case of the Empire Natural Gas Company, it had a capital stock of $10,574,000 and compared to such capital stock it had surplus of $6,066,436 and reserves for depreciation and depletion of $10,192,715, a total of surplus and reserves of $16,259,151, which is equal to 153.77 per cent of its capital stock.

"The plant investment of the Empire Natural Gas Company, including uncompleted job orders, as reflected in the books of the company as of November 30, 1926, was $26,577,355; its reserves for depreciation and depletion amounted to $10,192,715, which is equal to 38.35 per cent of the plant investment.

"In the case of the Kansas Natural Gas Company it had a capital stock of $6,000,000 and surplus of $7,784,067 and had accumulated reserves for depreciation and depletion amounting to $11,905,381. Its surplus amounted to 129.73 per cent of its capital stock and the combined surplus and reserves amounted to 198.42 per cent of its capital stock. The book value of its plant

investment was $18,861,223, including uncompleted job orders, and its reserves for depreciation and depletion of $11,905,381 was 63.12 per cent of such plant investment.

"The Empire Gas and Pipe Line Company had a capital stock of $5,000 and surplus of $907,323, which was 18,146.46 per cent of its capital stock. Its reserves for depreciation and depletion was $325,840, making the combined reserves and surplus $1,233,163, all of which was accumulated on a capital stock of $5,000.

"The plant investment of the Empire Gas and Pipe Line Company, including uncompleted job orders, was $1,625,569, compared with combined surplus and reserves of $1,233,163.

"The financial history of the company since the consolidation in November, 1926, may be found on pages 1 to 8, inclusive, in Exhibit 49, which reflects the combined operations of the Cities Service Gas Company, the Cities Service Gas Pipe Line Company and the American Pipe Line Company.

"It is shown that surplus has been accumulated, in excess of all interest and dividends paid, of $9,044,629 to June 30, 1931; its depreciation and depletion reserves have increased to $10,818,020. Its total assets have increased from $60,595,001 as of December 31, 1926, to $109,431,039 as of June 30, 1931. [During this time its outstanding stock and bonds increased only $28,365,700 and its loans only $9,000,000.]

"The Cities Service Gas Company has during all this time paid interest on its bonds and dividends on its

capital stock; in 1928 it paid $1,000,000 dividends, and in 1929 and 1930 it paid $2,000,000 each on dividends, which is at the rate of 8 per cent per annum. Its earnings before interest (and depreciation) were as follows:

1927	$5,335,739
1928	6,053,621
1929	8,660,793
1930	8,829,480
Twelve months ending June 30, 1931	8,741,809

"The net profit of the companies, after paying all interest charges available for reserves and common stock during each of the years 1927 to 1930, was:

1927	14.99%
1928	13.12%
1929	21.25%
1930	19.97%

"Its net return after paying all interest and other charges and providing substantial allowances for depreciation and depletion amounted to the following percentages of its outstanding capital stock during each of the years 1927 to 1930, inclusive:

1927	9.96%
1928	6.75%
1929	14.53%
1930	10.82%

"Page 1 of Exhibit 49 shows that the book value of plant investment, including uncompleted job orders, increased from $53,243,126 as of December 31, 1926, to $99,003,996 as of June 30, 1931, an increase of $45,760,868." (R. 530-2)

The First paragraph of Finding No. 18 of the Lower Court is as follows:

> "A return of approximately 8 per cent upon present values is necessary, under present conditions, to assure confidence in the financial soundness of the Cities Service Gas Company, to maintain its credit, and to enable it to raise money necessary for the discharge of its public duties. Any return substantially lower than that would be confiscatory. (United Railways v. West, 280 U. S. 234, 252.) (R. 317)"

Since the majority of the lower court based this finding upon the West Case, supra, a comparison of the facts in that case with the case at bar is appropriate.

In the West case, page 281, appears the following:

> "There is much evidence in the record to the effect that in order to induce the investment of capital in the enterprise or enable the company to compete successfully in the market for money to finance its operations, a net return upon the valuation fixed by the Commission should not be far from 8 per cent. Since 1920 the company has borrowed from time to time some $18,000,000.00 upon which it has been obliged to pay an average rate of interest ranging well over 7% and this has been the experience of street railway lines quite generally."

In the case at bar it is apparent that the affiliation and mutual assistance rendered by the great and efficient Doherty organization that this particular plaintiff is and has been able to sell its securities at an "interest rate that was from a half to three-fourths per cent less than anything else that was put out at about that time on a similar project, and that it gets better terms on its mortgages. Because of this situation it was able

to sell its 5½ per cent bonds for 96¼. This plaintiff having ample resources does not necessarily have to issue securities now or six months from now or two years from now. It picks and chooses its time when the markets are right." (R. 530).

The record shows this plaintiff sold twelve million dollars of first mortgages, pipe-line 6 per cent gold bonds at par. It is apparent, therefore, that it is able to obtain funds at a very low rate and is assured of financial stability and a supported credit which enables it to raise all necessary money for the proper discharge of its duties at a low rate of interest. It is apparent also that there is little risk or hazard in its business. The pipe line system which it has established is a permanent fixture for an indefinite period. It has a gas reserve which insures it of a supply of gas lasting well into the future. The territory which it serves is well protected; it has almost a monopoly on the territory which it serves due to the fact that the distributing units are affiliated companies and it would be economically unsound for another pipe-line company to invade its territory.

It appears from the evidence that the Company is fully financed and its system construction completed.

In the West case, page 251, we find the following:

> "Upon the valuation fixed, with an allowance for depreciation calculated with reference to that valuation, and upon the then prescribed rates, the company for the years 1920 to 1925, both inclusive, obtained a return of little more than 5 per cent per annum."

In the case at bar the net profit after paying all interest and other charges providing for substantial allowances for depreciation and depletion amounted to the following percentages of its outstanding capital stock during each of the years 1927 to 1930 inclusive.

1927	9.96%
1928	6.75%
1929	14.53%
1930	10.82%

In the case at bar, furthermore, in the year 1928 the company paid interest on its bonds and dividends on its capital stock, the dividend amounting to $1,000,000.00 and in the year 1929 paid interest on its bonds and dividends on its capital stock amounting to $2,000,000, and in the year 1930 paid interest on its bonds and dividends on its capital stock of $2,000,000, the dividends amounting to 8% per annum, and during the period the plant investment, including uncompleted job orders, increased from $54,243,128 on December 31st, 1926, to $99,003,996 on June 30th, 1931, an increase of $45,760,872.

In the case at bar in the majority opinion of the lower Court in its finding No. 12 appeared the following:

> "The Cities Service Gas Company was organized in 1926. It took over the physical properties of five pipe line companies having a plant investment account, at the time, of $52,182,325.98." (R. 301)

The record discloses that at that time in those companies reserve for depreciation and depletion had been accumulated out of earnings in the amount of $22,423,936.95 or 42.97% of the plant investment and at that time

these companies had accumulated a surplus amounting to $14,903,660.21, equal to 87.26% of the total capital stock of all the companies taken over.

When this company was thus organized and its books opened $17,080,000 of the capital stock and $2,000,000. of bonds became immediately $25,000,000 worth of common stock and $25,000,000 of 5½% bonds. The reserve for depreciation and depletion above set out in the amount of $22,423,936.95 became only $7,760,706 and none of the surplus of $14,903,660.21 above set out was carried over into the new corporation. (R. 173)

On June 30th, 1931, they had built up a surplus of $9,044,629, after having paid all of the dividends hereinabove referred to and the interest on the bonds. (R. 531)

In addition to paying the bond interest and the dividends above referred to the company loaned other affiliated companies $7,559,571. (R. 173)

The net earnings before interest and depreciation in

1927	5,335,739
1928	6,053,621
1929	8,660,973
1930	8,829,480
12 months ending June 30th, 1931	8,741,809

(R. 532)

In the case at bar it will thus be seen that the Cities Service Gas Company is one of the large system, and organized among other purposes for the purpose of maintaining the credit of subsidiary companies and it has been able to do that and conducted its business so as to meet its demands, to pay its operating expenses in-

cluding interest on bonds, to pay a dividend of 8% on its capital stock and in addition thereto to accumulate a surplus of $9,044,629 and its depreciation and depletion reserves have increased $10,818,020 since 1926. (R. 173)

In the West Case in the opinion on page 249 appears the following:

> "What is a fair return within this principle cannot be settled by invoking decisions of this court made years ago based upon conditions radically different from those which prevail today. The problem is one to be treated primarily by present day conditions. Annual returns upon capital and enterprise, like wages of employees, cost of maintenance and repleted expenses, have materially increased the country over. This is common knowledge. A rate of return upon capital invested in street railway lines and other public utilities which might have been proper a few years ago no longer furnishes a safe criterion either from the present or the future."

In the case at bar the very opposite exists. Annual returns upon capital and enterprise, like wages of employees, cost of maintenance and related expenses, have materially decreased the country over. This is common knowledge.

In Finding No. 18 in the majority opinion of the lower court appears the following:

> "There is evidence that in years past, the profits of the company exceeded 10 per cent."
>
> "We do not analyze those figures. *** " (R. 318)

We believe that consideration should be given to the experience of the recent past for the purpose of determining requirements for the future.

In the case at bar, furthermore, Judge Hopkins in his dissenting opinion cites the case of Wabash Valley Electric Company, vs. Young, 77 L. Ed. 348, 287 U. S. 488, and quotes from the opinion by Mr. Justice Southerland as follows:

> "It is true, as appellant points out, that in United Railways v. West, 280 U. S. 234, 251-252, this court held that a rate of return for a street railway of less than 7.44 per cent was confiscatory, saying that sound business management required that after paying all expenses of operation, etc., 'there should still remain something to be passed to the surplus account,' and that a rate of return which did not admit of that being done was 'not sufficient to enable a utility to maintain its credit and raise money for the proper discharge of its public duties. Many cases were cited tending to show that a return of 7½ per cent, or even 8 per cent, might be necessary, but it was said (pp. 249-250) that no rule could be laid down which would apply uniformly to all sorts of utilities. 'What may be a fair return for one may be inadequate for another, depending upon circumstances, locally and risk.' A street railway company compelled to meet the growing competition of private automobiles, public omnibuses, and other motor carriers, well might sustain such losses of revenue because of the decreased number of passengers carried, as to require a larger rate of return than would be required by an electric company like appellant, which not only enjoys a practical monopoly in the field where its services are rendered, but whose financial structure, it fairly may be assumed, is greatly strengthened by its affiliations and by the interested support of the parent company to which it belongs. On the whole we are unable to conclude that a 7 per cent rate of return, under the facts here disclosed, is so law as to be confiscatory. See Smith v. Illinois Bell Telephone Co. Supra, at pp. 160-161."

Furthermore in the case of Wabash Valley Electric Company vs. Young, Supra the following appears in the opinion, on 77 L. Ed. page 354; 287 U. S. 448, 501:

> "The testimony for appellant was to the effect that to take care of bonds, debt discounts, borrowed money and stock dividends a return of 7 per cent was sufficient; but that in order to accumulate a surplus and make it easier to finance the company, the rate of return should be not less than 8 per cent. Appellant's balance sheets show that on January 1, 1929, it had an accumulated surplus of $1,074,739.71, and, at the end of that year a surplus of $1,257,884.64, as compared with a total stock and funded debt liability of about $4,500,000. The record, as already stated, also shows that appellant is a subsidiary of the Central Indiana Power Company by which it is owned and financed, its securities having been taken directly by that company without any intervening agency. The power company also own and finances the other affiliated corporations in the same way. It is reasonable to conclude that appellant is in a more favorable financial condition than if it were a disconnected enterprise."

The Supreme Court in the recent case of Los Angeles G. & E. Corp. v. Railroad Commission, 289 U. S. 287, in its opinion said:

> "The Commission calculated that the Company would have a return of 7 per cent on this rate base.
>
> * * * * *
>
> "And we recognize that a rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally. See Smith v. Illinois Bell Teleph. Co., 282

U. S. 133, 160, 161, 75 L. ed. 255, 269, 270, 51 S. Ct. 65. Applying these principles, and considering the financial history of the Company, its relations and opportunities, and the general situation as to investments, we find it impossible to hold that a return of 7 per cent is so low as to be confiscatory."

In Finding No. 18, the majority Court states as follows:

"The witness for the Commission testified that 8 per cent would not be an unreasonable return in normal times, but testified that these times are abnormal, as they are. But if abnormality is considered, the return must be increased, not decreased. In these times when stock of the best utilities can be purchased on a 9 per cent basis or better, certainly an 8 per cent return on this hazardous enterprise is not unreasonable." (R. 318)

We cannot fathom the reasoning of the Court underlying this finding.

It is a very general principle of law that a public utility is entitled to earn such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties. The country has entered upon a changed economic level. We submit that it is common knowledge that under the present depressed and abnormal conditions, the earnings of the best organized and best financed concerns of the country are decreased and many of them are not even earning operating expenses. Rates

of interest on borrowed money are the lowest in the history of the country.

The Court designates this Company as being engaged in a hazardous enterprise, but its history is one of successful and profitable business with no real competition to meet in its field of service. The Company's pipe line system is entirely completed. It is fully financed, its market is assured and has existed for many years; it has practically a monopoly upon the territory which it serves for the reason that no other like company can afford to expend the enormous amounts of money necessary to invade its territory. It has an almost unlimited supply of gas; it deals in a commodity which is a household necessity. We submit that it is not now a hazardous enterprise.

In finding No. 12, the majority Court found:

> "Electricity supplanted gas for lighting and is making serious inroads on cooking, while fuel oil is proving a formidable competitor for heating." (R. 301)

Yet the record in this case shows that in the year of organization it produced and purchased 45,550,572 M.c.f. of gas, and in the test year 1930 it produced and purchased 74,163,945 M.c.f. In the first six months of 1931 it produced and purchased 34,547,379 M.c.f. (R. 491) In the year of 1930 the amount of gas it sold for other purposes was twice that sold for domestic use. There is no evidence in the record to support the Court's finding.

In abnormal times such as these we are now experiencing, a concern that is able to show any profit is the exception and even the strongest concerns in any business are contented and indeed fortunate if they can show a return of 6 per cent.

We believe that the fact that depressed conditions caused the decrease in earnings in 1931 and 1932 should be given consideration in determining a rate for the future.

The net income of the Company under investigation, before depreciation for the year ending December 31, 1931, shows a decrease of $707,434, as compared with the previous year. The net income for the year ending June 30, 1932, shows a decrease of $896,878 as compared with the previous year. (R. 515) This decrease is due almost entirely to the loss in sales of industrial gas during the present industrial depression. (R. 178) Unless it is to be assumed that the present economic conditions are to continue indefinitely, this decrease is abnormal and must be given consideration in using present earnings as the test for the future rate.

It is also true that the rate in controversy pertains only to domestic sales. The loss in income during the test period is due almost entirely to industrial sales. During the year 1931 as compared with 1930 domestic sales increased 686,310 M.c.f., while industrial sales showed a decrease during 1931 as compared with 1930 of 3,375,194 M.c.f. (R. 179) We believe that the Company should be required to carry part of the burden

due to loss in industrial sales pending the adjustment of the economic conditions and not place it all on the domestic consumer.

Considering the favorable position which the Company has financially, the support which it receives from affiliated companies, the assured market which it has for its gas, its gas reserves which insure its supply, its financial experience in the past, and the present economic conditions, we believe that a 6 per cent return is adequate.

EFFECT OF COMMISSION'S ORDER ON INCOME.

The order of the Commission was to the effect that the contract under which the Cities Service Gas Company sells gas to the distributing companies at the city gate at an average price of 39.5 cents per M.c.f. was unreasonable and that any payments made by the distributing companies in excess of 30 cents per M.c.f. should not be allowed as an operating expense. (R. 61)

The order in no way affected the price at which industrial gas was being sold. It pertained only to town border sales for distribution to domestic consumers.

In order to have some test by which to estimate the effect of the Commission's order it was agreed that,

> "The rate established by the Commission in its order Exhibits L — H if applied to the business of the Cities Service Gas Company for the year ending June 30, 1932, would result in a reduction of earnings of $1,926,145.07." (R. 372)

We have accepted the figure for the purpose of estimating the rate of return which the Company would earn under the Commission's order.

We do not concede however that the loss in income would have been $1,926,145.07 during the year ending June 30, 1932, if the Company had been operating under a 30 cent rate. If the Company's rate is reduced to 30 cents we believe that the amount of gas sold for domestic purposes will increase, and the increased consumption will increase the income of the Company.

Gas in the territory sold by the Company has become a household necessity. Wood and coal cannot compete with gas if the cost to the consumer is placed on a comparative basis. A reduction of the gas rate to 30 cents would no doubt greatly increase the consumption of domestic gas and the net return to the company might be sufficiently increased to make up the reduction in the gate rate.

ASSIGNED ERRORS 14, 17, 19.

RATE OF RETURN UNDER COMMISSION'S 30 CENT ORDER.

The anticipated test periods, when the investigation was started in the summer of 1931, covered the two annual periods ending December 31, 1930, and June 30, 1931. Before the hearing was completed six months had expired and the Company submitted an earning statement for the last six months of 1931. A rehearing was had and before it was completed another six months had

expired, and the Company submitted an earning for the annual period ending June 30, 1932.

The Commission then used the full test period agreed upon and also the annual period ending June 30, 1932, although it found:

> "That it would be inequitable to accept this figure of reduction in earnings without taking into consideration that reproduction costs new at this time would also cut valuations fixed by the Commission in its original opinion substantially." (R. 60)

The majority Court in its findings abandoned the original test period and used the annual periods ending June 30, 1931, and June 30, 1932, although it found that 1932 was an abnormal year. In using the earning statement from the annual period reflecting this decrease in earnings, the lower Court gave no consideration to the fact that prices for labor and material had also dropped which would have materially affected the rate base.

We have discussed under separate headings, the valuation of the properties entering into the rate base and the net additions made to plant and equipment during the annual periods covered by the test.

We have also discussed under separate headings, the Company's annual income, and depreciation and depletion requirements for each annual test period.

The reduction resulting from the Commission's order when tested by the sales in the past is agreed to be $1,926,145.07.

For the purpose of showing the effect of the Commission's order on the rate of retun, we have compiled a

table showing the rate base, net income before depreciation and depletion, the annual depreciation and depletion requirements, reduction in revenue under Commission's order, net income under Commission's order and the rate of return for each annual period covered by the investigation.

The table follows:

CITIES SERVICE GAS COMPANY.

NET INCOME, RATE BASE AND RATE OF RETURN FOR EACH ANNUAL TEST PERIOD.

	Dec. 31, 1930	June 30, 1931	Dec. 31, 1931	June 30, 1932
Net Income before depreciation	$8,829,480.71	$8,741,809.14	$8,228,178.30	$7,861,516.85
Add: 1%	75,022.33	68,882.05	68,882.05	52,297.13
Add: Rate case expenses				50,000.00
Total	8,904,503.04	8,810,691.19	8,297,060.35	7,963,813.98
Less: Depreciation	1,693,312.00	1,712,216.00	1,862,784.00	1,894,022.00
Annual Lease Rentals	1,060.00	1,060.00	1,060.00	1,060.00
Dry Hole Expense	12,000.00	12,000.00	12,000.00	12,000.00
Depletion of Producing Leases	70,509.88	70,509.88	70,509.88	70,509.88
Total	1,776,881.88	1,795,785.88	1,946,353.88	1,977,591.88
	$7,127,621.16	$7,014,905.31	$6,350,706.47	$5,986,222.10
Agreed reduction in revenue under Commission's order	1,926,145.00	1,926,145.00	1,926,145.00	1,926,145.00
Net Income under Commission's order	$5,201,476.16	$5,088,760.31	$4,424,561.47	$4,060,077.10
Average Value	$67,183,628.00	$67,808,300.00	$73,205,808.00	$74,181,902.00
Rate of Return	7.74%	7.50%	6.04%	5.47%

As shown by the above table under the Commission's order the Company would have been making approximately 8 per cent return during the year 1930 without giving any consideration to increase in sales which would result from the reduction in the rate.

The return for the year ended June 30, 1931, is 7.5 per cent. A slight decrease is shown. Loss of income from industrial sales is just starting to show its effect.

The return for the year ended June 30, 1932, is 5.47 per cent. The loss in industrial sales due to the present industrial depression had reached the maximum during the test period.

The lower Court found that 1932 was an abnormal year, stating:

> "We agree with the Commission that 1932 should not be taken as a test year, for it marks it is hoped, the low of the depression through which we are passing." (R. 314)

The lower Court however, disregarded its finding, abandoned the original test period, and based its findings on the annual periods ending June 30, 1931, and June 30, 1932.

We contend that the test period used by the majority Court was unfair. We have however prepared a table for the purpose of showing what the results would have been had the Court not erroneously increased the rate base and made depletion allowances for gas leases not used and useful. This calculation covers the same annual periods as used by the Court. The rate base and deprecia-

tion requirements as of September 1, 1931, have been used.

CITIES SERVICE GAS COMPANY.

NET INCOME, GIVING EFFECT TO DEPRECIATION ALLOWANCE ON VALUE AS OF SEPT. 1, 1931, AND RATE BASE OF SEPT. 1, 1931.

	—Year ended—		
	June 30, 1931	June 30, 1932	Average
Net Income Before Depreciation	$8,741,809.14	$7,861,516.85	$8,301,662.99
Add: 1¾%	68,882.05	52,297.13	60,589.59
Add: Rate case expenses		50,000.00	25,000.00
Total	$8,810,691.19	$7,963,813.98	$8,387,252.58
Less:			
Depreciation on 9-1-31 values	1,894,022.00	1,894,022.00	1,894,022.00
Annual Lease Rentals	1,060.00	1,060.00	1,060.00
Dry Hole Expense	12,000.00	12,000.00	12,000.00
Depletion of Producing Leases	70,509.88	70,509.88	70,509.88
Total	$1,977,591.88	$1,977,591.88	$1,977,591.88
Net Income Available for Return	6,833,099.31	5,986,222.10	6,409,660.70
Agreed Reduction in revenue under Commission's order	1,926,145.00	1,926,145.00	1,926,145.00
Net Income under Commission's Order	$4,906,954.31	$4,060,077.10	$4,483,515.70
Value, 9-1-31	$74,181,902.00	$74,181,902.00	$74,181,902.00
Rate of Return	6.61%	5.47%	6.04%

Had the majority Court given effect to its finding that 1932 was abnormal and should not be used as a test period and used the years ending December 31, 1930, and December 31, 1931, a more accurate test would have been obtained. We have made a calculation showing the results as to these periods using the rate base as of Sep-

tember 1, 1931, to make it comparable with the lower Court's findings, although over $11,000,000 of construction was done in 1930 and not in operation during that entire year to produce an income.

The table showing the rate of return for these two annual periods follows:

CITIES SERVICE GAS COMPANY.

NET INCOME GIVING EFFECT TO DEPRECIATION ALLOWANCE ON VALUES AS OF SEPT. 1, 1931, AND RATE BASE AS OF SEPT. 1, 1931, AVERAGE OF YEARS ENDED DECEMBER 31, 1930, and DECEMBER 31, 1931.

	—Year ended—		
	Dec. 31, 1930	Dec. 31, 1931	Average
Net Income before Depreciation.	$8,829,480.71	$8,828,178.30	$8,528,829.50
Add: 1¼%	75,022.33	68,882.05	71,952.19
Total	$8,904,503.04	$8,297,060.35	$8,600,781.69
Less: Depreciation on 9-1-31 values	1,894,022.00	1,894,022.00	1,894,022.00
Annual Lease Rentals	1,060.00	1,060.00	1,060.00
Dry Hole Expense	12,000.00	12,000.00	12,000.00
Lease Depreciation of Producing Leases	70,509.88	70,509.88	70,509.88
Total	$1,977,591.88	$1,977,591.88	$1,977,591.88
	6,926,911.16	6,319,468.47	6,623,189.81
Agreed Reduction in Revenue Under Commission's Order	1,926,145.00	1,926,145.00	1,926,145.00
Net Income under Commission's Order	$5,000,766.16	$4,393,323.47	$4,697,044.81
Value, 9-1-31	$74,181,902.00	$74,181,902.00	$74,181,902.00
Rate of Return	6.74%	5.92%	6.33%

As we have previously stated, the Company was completing pipe line extensions during the year 1930, some of it extending into the year 1931. As this property was not in operation and producing an income during all of the year 1930, we do not believe it proper to include it in the rate base when considering the return during that period.

The following table shows the return earned after making such adjustment:

CITIES SERVICE GAS COMPANY.

NET INCOME, AVERAGE VALUE AND RATE OF RETURN AVERAGE FOR YEARS ENDED DECEMBER 31, 1930, AND DECEMBER 31, 1931.

	Year ended Dec. 31, 1930	Year ended Dec. 31, 1931	Total	Average
Net Income before depreciation	$8,829,480.71	$8,228,178.30	$17,057,659.01	$8,528,829.50
Add: 1¾%	75,022.33	68,882.05	143,904.38	71,952.19
Total	8,904,503.04	8,297,060.35	17,201,563.39	8,600,781.69
Less: Depreciation	1,693,312.00	1,862,784.00	3,556,096.00	1,778,048.00
Annual Lease Rentals	1,060.00	1,060.00	2,120.00	1,060.00
Dry Hole Expense	12,000.00	12,000.00	24,000.00	12,000.00
Depreciation of producing leases	70,509.88	70,509.88	141,019.76	70,509.88
Total	1,776,881.88	1,946,353.88	3,723,235.76	1,861,617.88
	$7,127,621.16	$6,350,706.47	$13,478,327.63	$6,739,163.82
Agreed reduction in revenue under Commission's order	1,926,145.00	1,926,145.00	3,852,290.00	1,926,145.00
Net Income under Commission's order	$5,201,476.16	$4,424,561.47	$9,626,035.63	$4,813,018.82
Average Value	$67,183,628.00	$73,205,808.00		$70,194,718.00
Rate of Return	7.74%	6.04%		6.86%

This shows a return of approximately 7 per cent, and includes the loss in income from industrial gas for the year 1931. If we can anticipate a recovery of industry in the future, the return of industrial sales would bring this return over 8 per cent.

The Commission used the test period which was suggested when the investigation started and included also the year ending June 30, 1932, and found a rate of return slightly below 7 per cent upon its valuation. The Commission however took cognizance of the fact that labor and material prices had declined since the valuation was made by the engineers, and stated that this must be given consideration if the abnormal year 1932 was used in the test period.

The calculation of the Commission adjusted according to the stipulation as to overhead values is as follows:

CITIES SERVICE GAS COMPANY.

NET INCOME, AVERAGE VALUE AND RATE OF RETURN AVERAGE FOR YEARS ENDED DECEMBER 31, 1930, JUNE 30, 1931, AND JUNE 30, 1932

	Dec. 31, 1930	June 30, 1931	June 30, 1932	Average
Net Income before Depreciation	$8,829,480.71	$8,741,809.14	$7,861,516.85	$8,477,602.23
Add:				
1¾%	75,022.33	68,882.05	52,297.13	65,400.50
Rate case Expenses			50,000.00	16,666.67
Total	$8,904,503.04	$8,810,691.19	$7,963,813.98	$8,559,669.40
Less:				
Depreciation	$1,693,312.00	$1,712,216.00	$1,894,022.00	$1,766,516.66
Annual Lease Rentals	1,060.00	1,060.00	1,060.00	1,060.00
Dry Hole Expense	12,000.00	12,000.00	12,000.00	12,000.00
Depletion of Producing Leases	70,509.88	70,509.88	70,509.88	70,509.88
Total	$1,776,881.88	$1,795,785.88	$1,977,591.88	$1,850,086.54
	7,127,621.16	7,014,905.31	5,986,222.10	6,709,582.86
Agreed Reduction in Revenue under Commission's order	1,926,145.00	1,926,145.00	1,926,145.00	1,926,145.00
Net Income under Commission's order	$5,201,476.16	$5,088,760.31	$4,060,077.10	$4,783,437.86
Average Value	$67,183,628.00	$67,808,300.00	$74,181,902.00	$69,724,610.00
Rate of Return	7.74%	7.50%	5.47%	6.86%

At the risk of being tiresome, we have set out these various tables showing the results from the use of the various test periods.

We believe that an accurate picture is presented by them.

Under any of the test periods used, the Company will be making a return of over 6 per cent and if the abnormal year 1932 is eliminated the return materially increases.

DECREASED INCOME DUE TO LOSS OF INDUSTRIAL SALES—VALUE OF DOMESTIC SERVICE.

The Company's loss in income during the period covered by the investigation was due almost entirely to loss in industrial sales. During the same period gas sold for domestic use showed an increase.

During the year 1931 as compared with 1930, domestic sales increased 686,310 M. c.f., while industrial sales showed a decrease during the year 1931 as compared with 1930 of 3,375,194 M. c.f. Domestic sales increased $347,415.85, during the 1931 period compared with 1930 and other sales decreased $957,385.57. (R. 179)

The net income before deducting annual depreciation and depletion requirements, for the first and last annual period covered by the investigation, is as follows:

Year ending:	
Dec. 31, 1930	$8,904,503.00
June 30, 1932	7,963,813.00
Decrease	$ 940,690.00

This shows a loss in income of approximately a million dollars due almost entirely to loss of industrial sales caused by the present financial depression. There was some loss in domestic sales the first six months of 1932 which was largely offset by gains in domestic sales in 1931. Had it not been for this temporary loss in income from loss of industrial sales the Company would be making an unreasonable return under the Commission's order.

The net profits to the Company after paying all interest charges, which were available for reserves and common stocks during each of the years 1927 to 1930 was:

1927	14.99%	1929	21.25%
1928	13.12%	1930	19.97% (R. 532)

If the Company's income is temporarily reduced because of loss of industrial sales, we do not believe the burden of maintaining it should be carried by the domestic patrons.

The evidence showed that in past years the net return after depreciation and depletion requirements of the Company had exceeded ten per cent. As to this evidence the lower Court stated:

> "There is evidence that in years past, the profits of the Company exceeded 10 per cent. We do not analyze those figures; in rate making the past must bury its dead; a confiscatory rate cannot be ordered for the future because an exorbitant profit was made in the past." (R. 318)

With the Court's statement as a general proposition of law we agree, but the Court in applying the law, overlooked the material proposition.

In determining the return which the Company will make in the future it is proper to consider its experience in the past. The past earnings were excessive. The Company's earnings have decreased because of loss of industrial sales. That loss was caused by an abnormal condition. If abnormal, it will improve in the future. If the decrease in earnings due to depressed industrial

conditions is not given consideration the future rate will be unreasonable.

The Commission's order affects only the rate for gas sold for domestic consumption where the rate is in excess of 30 cents per M. c.f.

The temporary decrease in industrial sales has not increased the value of the service to the domestic consumer.

The rights of a particular class of patrons cannot be ignored. A utility should not be allowed to maintain rates that are unjust to one class of its patrons because there has been a temporary loss of income from another. The constitution does not require that temporary loss in income be remedied by imposing an unreasonable burden upon only one class of patrons.

In Covington & L. Turnpike Road Co. v. Sanford, 164 U. S. 578, 41 L. ed. 560, it was held:

> "The interests of the public as well as of the owner of the property must be considered, with all the circumstances, in determining what is a just rate to be charged by a turnpike company."
>
> "The right of a corporation to realize a given per cent upon its capital stock cannot be claimed without reference to the interests of the public. *** " (Syl. 9 & 10)

The test as to the value of the service was stated in Cotting v. Godard, 183 U. S. 79, 46 L. ed. 92, as follows:

> "The question is always, not what does he make as the aggregate of his profits, but what is the value of the services which he renders to the one seeking and receiving such services." (p. 97)

We submit that when consideration is given to the tem-temporary decrease in income due to loss of industrial sales the return to be earned under the Commission's order is ample.

If the rate of return is affected by a temporary decrease in industrial sales the Company should carry part of the burden and not place it all on the domestic consumer because the value of the service to him has not increased.

In Smyth v. Ames, 169 U. S. 466, 42 L. ed. 819, it was held:

> "The public have a right to be exempt from unreasonable exactions; and the interest of the corporation is not the sole test of suitable rates." (Syl. par. 12)

In the opinion, the Court said:

> "What the Company is entitled to ask is a fair return upon the value of that which is employed for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth." (p. 547)

ASSIGNED ERROR No. 20.

The Court, in its finding No. 20, found as follows:

> "If the distributing companies are compelled to pay 40 cents per thousand cubic feet for gas at the city gates and to base their rates to the consumers upon the price fixed as reasonable by the Commission, no one of them will have earnings in excess of operating expenses applicable to depreciation and return." (R. 319)

We believe that the finding is outside of the issue herein, and that there is no competent evidence in the record to support it.

The Commission appreciates the fact that before anything can be done in the way of determining the reasonableness of the distributing companies' gas rates to the domestic consumer, a determination must first be made of the reasonableness of the price which they pay to their affiliated pipe line company for gas which they distribute.

There being over one hundred of these separate distributing plants it was not practicable to try the reasonableness of the pipe line company's gate rate separately with each distributing plant. All of the distributing companies being similarly affected, the Commission had a joint hearing of all of the companies for the purpose of determining only the reasonableness of the contracts with the affiliated companies.

At the start of the investigation, the distributing companies raised no objection to the jurisdiction of the Commission to determine the reasonableness of the gate rate charged them by their affiliated pipe line company.

The distributing companies, however, objected to the Commission making any finding as to their several earnings or the several valuations of their property in this joint hearing.

They objected to any evidence being submitted upon these questions, contending that the reasonableness of the gate rate must first be established and that each distributing plant would then have the right to a separate and independent hearing as to the reasonableness of its rate giving effect to the Commission's order as to a reasonable amount which should be paid for gas to its affiliated pipe line company.

Mr. Stone, appearing for the distributing companies, stated as follows:

> "Mr. Stone: Now, if the Commission please, the last paragraph of the citation issued by the Commission contains this statement: 'It is further by the Commission ordered: That each of the above-named respondents appear on the above mentioned date to give to the Commission such information as they may desire on their own behalf, and as may be required by the Commission, in behalf of said investigation, and to show cause why such holding company contracts, or service or commodity charges, should they be (fol 266) found to be unreasonable should not be disallowed as operating expense of the distributing companies, and adjustment made in this respect as to charges made to the consumers.' Now that paragraph, your honors, seems to contemplate that should you find forty cents to be too high at the city gate it should be reduced say to thirty-five cents, or thirty cents, that that reduction of five or ten cents should be immediately adjusted as to each distributing company without any separate hearing as to the needs and requirements of that particular company.

* * * * *

Mr. Stone: Our understanding was that the Commission contemplated proceeding then to make such adjustment without any hearing, and that is why we have filed these appearances as to each company, and I will read it so you may understand our position. Maybe there is no difference.

* * * * *

Mr. Stone: After stating the appearance, we say: 'Said respondent hereby expressly limits its appearance and appears specially for said purposes and said purposes only hereby expressly objecting to any consideration by this Commission in this proceeding of the reasonableness or unreasonableness of its existing rates or any attempt to change the same by reason of any findings which this Commission may make in respect to said contracts from the evidence introduced herein and expressly denying the jurisdiction of the Commission to consider in this proceeding any issue as to the value of respondent's property, the adequacy or inadequacy of its earnings or the reasonableness or unreasonableness of its rates for the following reasons:" (R. 236-7)

It therefore clearly appears that the distributing companies challenged the jurisdiction of the Commission to investigate anything in the joint hearing except the reasonableness of the contracts between the affiliated companies.

Before the hearing closed, the distributing companies attempted to introduce general testimony pertaining to the value of their distributing plants and their income. The Commission sustained the objection to this testimony. The action of the Commission was in conformity with the original position of the companies.

In their bills of complaint before the District Court, the companies complained of the Commission's refusal to allow them to introduce such general testimony and the question went before the District Court in the following manner:

> "It is further stipulated that the witness F. C. Hamilton will testify that if the several distributing companies complainants herein are compelled to pay the price they are now paying the Cities Service Gas Company for gas at their respective city gates and are compelled to base their rates to consumers upon the price fixed by order, Exhibit M, they will not be able to make operating expenses, with nothing for return and depreciation on the value of their property, to which testimony the Commission objects on the ground of incompetency, the subject matter not coming in issue until the Commission has made an investigation for the purpose of determining the fair value of the properties owned by the distributing companies and their rate of return." (R. 371)

Upon this statement alone the Court made its finding 20.

It was conceded by counsel for the Commission before the District Court and is now conceded that the Commission had no authority to order a reduction in the rates of the distributing companies until they were given a separate hearing on the reasonableness of their rates regardless of the reduction in the pipe line rate.

We respectfully submit that the record does not justify such finding by the Court and that the distributing companies' position in requesting it is inconsistent with their position before the Commission.

The only question presented by this controversy is the

reasonableness of the contract between the pipe line company and the affiliated distributing companies. Until the reasonableness of the pipe line company's charge is determined, a finding as to the reasonableness of the distributing companies' expense cannot be made for the purpose of determining a proper rate for them to charge to the ultimate consumer.

ASSIGNED ERROR No. 4.

"The court erred in not accepting the findings of fact, declarations of law, and dissenting opinion of Honorable Richard J. Hopkins declaratory of the law and facts controlled in this action."

Hopkins, D. J., filed a dissenting opinion and findings of fact and conclusions of law. The opinion shows that it is the result of painstaking study and a thorough understanding of the evidence as shown by the record. This opinion adopts the findings of the Commission as to the valuation of the property and the return earned thereon, except two items that did not materially affect the rate base, and concluded that after an investigation of the facts and the law that plaintiffs had failed to show that the order in controversy made by the Public Service Commission of Kansas was unlawful or confiscatory.

We agree with Judge Hopkins that the effect of the reduction of the gate rates would be to increase the amount of gas sold for domestic purposes and to increase the return of the Company. Gas in the territory

served by the Company has come to be a household necessity. No one in its territory would burn wood or coal if he could obtain gas at somewhere near the same cost. A reduction of the gate rate from 40¢ to 30¢ would no doubt greatly increase the consumption of the domestic gas and the net return of the Company and might even increase the return to the Company sufficient to make up the reduction in the gate rate.

Judge Hopkins in his opinion shows careful consideration of the evidence pertaining to the gas leases and going value. The two accounts make up the chief difference between the value found by the Court and that found by the Commission.

After considering all of the evidence on gas leases, he concludes as follows:

> "In my opinion the Commission was well within its powers in finding that 71,267 acres of plaintiffs' gas reserves, which are in addition to its purchase contracts, covering 782,421 acres and 1,502 wells, with a potential of 1,532,625 M. C. F. per day, are used and useful to the company's developed acreage 27,910 acres of which is in the sweet proven gas area of the Amarillo field. The testimony of the officers of the company that they considered all of the 1,262,361 acres held by it as necessary for its future requirements, is not sufficient to overcome the actual facts, that it has an adequate supply for twenty-two years in the future. It would be contrary to common sense and justice to require the present consumers to pay for gas reserves which are not now used and which might never be used for their needs." (R. 331)

His conclusion as to Going Value is also to the point:

> "It is perfectly apparent that both witnesses arrived at their calculations for idle plant upon a hypothetical basis without considering the actual facts and experiences of the company. It appears that the Commission applied the tests which both engineers laid down as a proper measure of determining going-concern value and found that $2,000,000 was sufficient and proper allowance.
>
> The record shows clearly that on the major part of the pipe-line system there was very little idle plant following the construction period." (R. 333)

We also wish to call the Court's attention to Judge Hopkins' conclusion as to the evidence pertaining to the valuation as a whole:

> "The Commission saw and heard the witnesses, painstakingly examined their testimony and with the discretion allowed it under the law, arrived at what it determined the fair and reasonable value of plaintiff's property. And while it is the duty of this court to make an independent investigation of the facts which it has done, this court should be careful not to substitute its judgment for that of the Commission, unless it is clear that the Commission erred. ***
>
> The evidence in my opinion fails to disclose on such items sufficient reasons for setting aside the findings of the commission and substituting those of this court, nor does the evidence justify a finding of this court that a gate rate of 40 cents to the distributing companies is fair and reasonable." (R. 328)

We have, in our brief, called the Court's attention to the failure of the majority lower court to give consid-

eration to loss of industrial sales during the present financial depression.

This was recognized by Judge Hopkins in the following language:

> "In 1930 the effect of the depression began to affect sales and earnings of the company largely through loss of industrial business, a business bound to be regained as industrial business improves; and it goes without saying that the carrying the investment and expense of industrial business should not be placed on the domestic consumer." (R. 326)

With reference to the rate of return and what is fair rate as applied to this company under the circumstances shown in the evidence and as they exist throughout the world at the present time, Judge Hopkins says:

> "We are also confronted with changed conditions affecting opportunity for investment which tends to limit the amount of the return. Annual returns upon the capital have materially decreased in the past two or three years. Business is generally satisfied with a very low rate of return. All businesses, including that of public utilities, are satisfied with a much less rate of return than they were three or four years ago when annual returns upon the capital were unreasonably high."

> "The Cities Service Gas Company is not an ordinary public utility. It is one of a large system organized for the purpose of maintaining the credit of subsidiary companies and assisting them in their finances. It has been able to expand its business so as to meet increased demands, to pay its operating expenses, including interest on money borrowed, to pay dividends of 8 per cent upon its capital stock and accumulate a large surplus. (See Smith v. Illinois Bell Telephone Co., 282 U. S. 159, 161.)" ***

"A return of six per cent is not unreasonable at this time. In fact, the great majority of concerns now doing business are glad to earn as much as five per cent and are fortunate to do so. Even a five per cent return at this time would not be confiscatory."

(R. 335)

This Court will take judicial knowledge that the facts are correctly stated and we submit that the conclusion that Judge Hopkins drew from these facts that

"Even a five per cent return at the time would not be confiscatory."

logically follows.

ASSIGNED ERRORS Nos. 1, 2, 3, 21 AND 22.

We contend in view of what we have said heretofore, that the lower Court was in error; in permanently enjoining and restraining the enforcement of the Commission's order providing that the distributing companies should cease to set up on their books as an expense item any payments made to the Cities Service Gas Company for main line town border gas in excess of 30 cents per M. c. f., and should give no consideration to any such payments in fixing a rate for the domestic consumers; in finding and declaring the order of the Commission was unreasonable and would, if not enjoined, confiscate the property of plaintiffs; in holding that 40 cents per thousand cubic feet for gas at the city gates is a reasonable charge; in its conclusion that the portion of the first order of the Commission made August

31, 1932, providing that the distributing companies should give no consideration to the payment for gas at the city gates in excess of 30 cents per thousand cubic feet in fixing the rate for domestic consumers, should be permanently enjoined; and in refusing to dismiss plaintiffs' bills.

CONCLUSION.

We respectfully submit that the Court was in error in its findings of fact and conclusions of law, and in its failure to dismiss the plaintiffs' bills of complaint.

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